The Future of the Transnational:
An Evolving Global Role

Following several decades in which powerful forces of globalization unleashed a period of growth that drove the overseas development and expansion of many multinational enterprises (MNEs), questions are now being raised about what responsibilities come with the power that these large global companies have accumulated. In this final chapter, we address this question by examining the role of the MNE in the global political economy of the early twenty-first century.

This period of growth in the global economy has also advanced the progress of most large nation-states in which MNEs operated, as their economic and social infrastructure benefited from the value created through booming cross-border trade and investment. However, another group of countries has remained largely in the backwash of the powerful development forces of globalization. While the richest nations argued that the rising tide of globalization would lift all boats, to those in the poorest countries, it appeared to be lifting mainly the luxury yachts. And despite half a century of effort, the government-sponsored aid programs designed to narrow the growing gap between rich and poor nations have exhibited surprisingly little positive impact. With a third of the world's population subsisting on less than $2 a day, many have begun to feel that the MNEs that benefited so greatly from global economic expansion now have a responsibility to help deal with the unequal distribution of their benefits.

After discussing this evolving situation, this chapter will describe four different postures that MNEs have adopted in recent decades, ranging from the exploitative and the transactional to the responsive and the transformational. Although these are presented as descriptive generalizations rather than definitive normative categories, in today's global environment, there is a strong push to have companies move away from the exploitive end of the spectrum toward the responsive and even transformative end. These expectations are set out in documents ranging from the U.N. Global Compact to the voluntary industry norms and standards that have been established to provide guidance to the way the MNEs might think about their responsibilities abroad as they expand their operations into the 21st century.

For most transnational companies, the dawning of the new millennium offered exciting prospects of continued growth and prosperity. Yet, in the poorest nations on Earth, the reputation of large MNEs from the world's most developed countries was shaky at best.

and in some quarters, it was in complete tatters. Indeed, a series of widely publicized events in the closing years of the twentieth century led many to ask what additional constraints and controls needed to be placed on their largely unregulated activities:

- In Indonesia, Nike employed children in unhealthy work environments, paying them $1.80 a day to make athletic shoes being sold for a $150 a pair to affluent Western buyers.
- In Europe, Coca-Cola refused to take responsibility when consumers of soft drinks produced at its Belgian plant reported getting sick, then finally acknowledging the problem only after 100 people had been hospitalized and five countries had banned the sale of its products.
- In India, a regional government was trying to cancel a contract with Enron for the construction of the Dabhol power station and the supply of power, citing the company's "fraud and misrepresentation" during the original negotiations.
- In South Africa, 39 Western pharmaceutical companies sued the government and President Nelson Mandela to prevent the importation of cheap generic versions of patented AIDS drugs to treat the country's 4.5 million HIV-positive patients.

Each of these situations involved complex, multifaceted issues to which intelligent managers presumably believed that they were responding in a logical, justifiable manner—conforming to local labor laws and practices at Nike, conducting quality tests and communicating the data at Coke, enforcing legal contract provisions at Enron, and protecting intellectual property rights by the drug companies. Yet in the court of public opinion, their rational, abstract, or legalistic arguments were swamped by an overarching view of Western multinational companies operating out of greed, arrogance, and self-interest. They were seen as hammers driving home a widening wedge between the "haves" and the "have nots."

The Growing Discontent

Partly as a result of this growing distrust of MNEs, a popular groundswell against globalization began to gather strength in the early years of the 21st century. Prior to this movement, globalization had been widely viewed as a powerful engine of economic development, spreading the benefits of free market capitalism around the world. Yet the increasingly apparent reality was that far fewer developing countries had seen the benefits of this much-discussed tidal wave of trade and investment. Indeed, to some who lived in these countries, the growing gap between the rich and the poor offered clear evidence that "globalization" was just the latest term for their continued exploitation by the developed world through the agency of MNEs.

As a result, delegates from a number of developing nations agreed to block what they saw as unfair rules being imposed by richer nations at the World Trade Organization (WTO) meeting in Seattle in 1999. Supported by a large number of demonstrators, this conference represented the first high-profile protest against the increasing globalization of the world's economy, which many in the West believed was as beneficial as it was inevitable. The prime targets of the protests were the trade ministers from the world's richest countries and the multinational corporations that the demonstrators saw as the

main drivers and beneficiaries of globalization. It became a watershed moment that forced many MNEs to review their past practices and their future priorities.

The Seattle protests received even more public attention when police began using pepper spray and tear gas against demonstrators, mobilizing a great deal of public sympathy and support for their cause. In subsequent years, as the protesters continued their actions, their arguments were being buttressed by powerful allies, including the Nobel laureate Joseph Stiglitz, a former chairman of the Council of Economic Advisors and chief economist at the World Bank. In his book *Globalization and Its Discontents*, Stiglitz suggests that previous actions of the WTO, the International Monetary Fund (IMF), and the World Bank had often damaged developing countries' economies more than they had helped them.[1] He pointed out that although the First World preached the benefits of free trade, it still protected and subsidized agricultural products, textiles, and apparel—precisely the goods exported by Third World countries. And rather than seeing MNEs as creating value in developing countries, Stiglitz suggested that their effect was often to crowd out local enterprise, and then use their monopoly power to raise prices.

But the developing world's arguments were most dramatically confirmed by the World Bank's ongoing annual reports on the number of people worldwide living below the poverty threshold.[2] The data confirmed modest progress in reducing the number of people living on less than $2 a day (in constant purchasing price parity) from 2.59 billion in 1981 to 2.47 billion in 2008. Yet despite the impressive growth of countries like India and China during that time, after almost three decades of globalization-driven growth, the World Bank's data showed that more than a third of the world's 7 billion people were still living in extreme poverty.

The Challenge Facing MNEs

Given the extent of global poverty and the lack of clear significant progress in reducing it, a growing view began to emerge that it was time to radically rethink an approach that relied so heavily on government-funded aid programs. William Easterly, a former research economist at the World Bank, pointed out that after developed countries had provided $2.3 trillion of aid to developing countries over the past five decades, it is clear that the West's model of development has failed.[3] He argued that a large portion of foreign aid takes a paternalistic view in defining both the problems and the solutions and providing for neither accountability nor feedback. As a result, for example, $5 billion of internationally funded aid has been spent over the past 30 years on a publicly owned steel mill in Nigeria that has yet to produce any steel.

In contrast, the outstanding success stories in India and China have been achieved by unleashing the power of their market economies rather than through massive aid programs. In what the World Bank has called "the greatest poverty reduction program in human history," hundreds of millions of people in China have moved out of poverty since the late 1970s. In large part, this amazing transformation has been due to the

[1]Joseph E. Stiglitz, *Globalization and Its Discontents* (New York: WW Norton & Company, 2002).
[2]World Bank, *Poverty Reduction and the World Bank* (Washington, D.C.: World Bank, 1999); World Bank, *Attacking Poverty* (New York: Oxford University Press, 2001).
[3]William Easterly, *White Man's Burden* (New York: Penguin Press, 2006).

investment of $870 billion by 300,000 approved foreign enterprises in the 30 years following the announcement of China's open-door policy in 1979. Included in that total are 490 of the world's top 500 companies, who not only see China providing them access to low-cost labor and a huge fast-growing market, but also as a technology source in which they have established 1,160 R&D centers. In addition to helping China, their investments are now having a significant economic impact on these firms, which sent almost $300 billion in profits out of China in the period from 1990 to 2007. Such a win-win consequence is due to one undeniable reality: The faster the poor gain wealth, the faster they become customers.

In light of this impressive record, the eyes of many in the international community began to turn toward the MNEs to provide at least a part of the solution to the intractable problems that many developing countries faced. But this has required more than just a public relations exercise extolling the benefits of free trade and openness to foreign investment. It has meant understanding what role MNEs might play in dealing with some of the underlying causes of the widespread discontent in the developing world. In financial power alone, the World Bank estimated that the flows of foreign direct investment into developing countries in 2010 was about $416 billion, more than four times the amount of foreign aid and development funding flowing into that same group of countries.

For the MNEs, the immediate challenge has been to decide how to respond to the growing public resistance to the globalization forces that drove their growth and expansion during the previous half-century. Their longer-term challenge is to determine whether they are willing to step up and take a leadership role in dealing with the problems that are the underlying causes of the anti-globalization movement.

Responding to Developing World Needs: Four MNE Postures

To understand how MNEs have faced such issues in the past and how they might in the future, we will describe four somewhat archetypical responses along a spectrum of possible action, ranging from an approach we label "exploitive" to one we describe as "transformative." Our observations suggest that most MNEs have moved away from the former model; many believe that it is in their long-term interest to shift toward the latter.

The Exploitive MNE: Taking Advantage of Disadvantage

As we saw in Chapter 1, because one of the strongest and most enduring motivations for a company to internationalize is its desire to access low-cost factors of production, the ability to locate cheap labor has long encouraged many MNEs to enter emerging markets. To anyone operating in these environments, it soon became clear that not only were the wages significantly below those in developed countries, but so were the health and safety standards, the working conditions, and even the human rights of the workers. The question facing MNE management was how to respond to that situation.

For a subset of the companies that we describe as "exploitive MNEs," the lower the labor rate, the longer the workweek, the fewer the restrictions on working conditions, and the less regulation on workers' rights, the better. The companies that we place in

this category believe that cross-country differences in wages, working conditions, legal requirements, and living standards all represent unfettered opportunities for them to capture competitive advantage.

Such an attitude received its strongest support in the 1970s in the writings of University of Chicago economist Milton Friedman. Guided by the view that companies had a responsibility to maximize profits and that shareholders were their only legitimate stakeholder, he argued that "[those who believe that] business has a 'social conscience' and takes seriously its responsibilities for providing employment, eliminating discrimination, avoiding pollution . . . are preaching pure and unadulterated socialism."[4] Such bold, clear absolutes from a Nobel laureate in economics provided the exploitive MNEs all the cover they needed to embrace their oppressive stance, and during the 1960s and 1970s, many did. Surprisingly, a few still operate this way today.

One of the most commonly held negative images of MNEs relates to the use of "sweatshops"—workplaces characterized by some combination of hot, crowded, poorly ventilated, poorly lit, and unsafe environments—in which the labor force, often including children, works long hours for less than a "living wage." Unfortunately, these are not just examples of extreme situations from an era long past. In 2006, *The New York Times* reported that a large number of workers from Bangladesh each paid $1,000 to $3,000 to agents in return for the promise of work in Jordanian factories producing garments for Target and Wal-Mart. After they arrived at their new place of work, their passports were confiscated to ensure that they did not quit. Not only were they paid less than promised (and far less than the country's minimum wage), they were forced to work 20-hour days and were hit by supervisors if they complained.[5]

Most MNEs have tried to avoid criticism around the sweatshop issue by outsourcing manufacturing to arm's-length suppliers. But as Nike, Wal-Mart, and many other high-profile companies found, such tactics are no longer effective in insulating the MNE from responsibility. Stories such as the one in *The New York Times* have resulted in widespread consumer outrage and public demands that MNEs take responsibility for the suppliers with whom they contract to make their products. In recent years, major companies, including Apple, Nike, and Wal-Mart, have all yielded to the pressure of consumer boycotts and public criticism to step up monitoring of their suppliers.

Yet despite the risks, when the pressure from governments, nongovernmental organizations (NGOs), and supranational agencies becomes too great, MNEs committed to an exploitive approach will simply close down and move their factory to another city, state, or country. These companies understand that many countries are actively working to develop employment, increase their tax base, and capture spin-off benefits from new investment, and they do not hesitate to play countries against one another. A classic example was provided by several companies making soccer balls in Pakistan. When publicity about the widespread use of child labor forced them to change their practices, many simply provided the employees materials that could be stitched by the children in their

[4]Milton Friedman, "The Social Responsibility of Business Is to Increase its Profits," *The New York Times Magazine*, September 13, 1970.

[5]Steven Greenhouse and Michael Barbaro, "An Ugly Side of Free Trade: Sweatshops in Jordan," *The New York Times*, May 3, 2006.

homes. Others simply responded to government incentives to relocate to Bangladesh, where the use of child labor continued.

In countries where corruption and bribery are common, this push for concessions and subsidies from local government officials and regulators has led some exploitive MNEs to engage in illegal activities. Justifying their actions with an attitude of "when in Rome . . . ," some firms have been willing to engage in such practices in the name of maximizing profits. In a couple of notorious examples from the 1970s, United Brands was charged with bribing the president of Honduras to help maintain a banana monopoly, and the U.S. conglomerate ITT was accused of conspiring to work with the Central Intelligence Agency (CIA) to overthrow the democratically elected government of Chile.[6] In response, the U.S. Congress passed the Foreign Corrupt Practices Act (FCPA) in 1977. Yet corrupt payments have continued, as confirmed by the fact that between 2007 and 2011, the U.S. government collected almost $4 billion in FCPA fines, the most recent high-profile case being Wal-Mart's cover-up of millions of dollars in bribes in Mexico to obtain permits to allow store development.

Global exploitation can move well beyond an ethics-free pursuit of low-cost labor and subsidized investment. It has led some companies to seek market expansion regardless of the likely resulting economic, social, or cultural damage. One classic example unfolded in the mid-1970s, when Nestlé and other infant formula manufacturers became concerned that birth rates in most industrialized countries were flattening and declining. Shifting their attention to what seemed like huge opportunities in these emerging-country markets, they began a major marketing push in those countries. Their tactics involved employing sales promoters dressed as nurses to hand out samples and providing hospitals with discharge kits of bottles and baby milk powder.

Subsequent reports of increases in infant mortality and malnourishment soon had many concerned that the practice was having major negative health consequences. It was discovered that mothers saw infant formula as "modern and Western," and the practice of breastfeeding declined. But because they could not afford to use the formula at the recommended level, they diluted it. Not only was the baby not receiving necessary nutrients, but the water being used to mix the formula often was unsanitary, leading to diarrhea, dehydration, and malnutrition. Worse still, the baby was not receiving all the immunities normally transferred from the mother via breastfeeding, again making the child less resistant to sickness.

In the ensuing public outrage, consumers worldwide boycotted Nestlé products. Even today, more than three decades later, that boycott continues, supported by NGOs such as Save the Children, CARE, and World Vision, protesting what they believe to be continued unethical practices promoting infant formula in Laos, Bangladesh, and other developing countries.

Beyond the direct way that it affects the lives of its employees and customers, the MNE also has an impact on the local communities in which it operates. In its single-minded focus on maximizing profit, however, an exploitive MNE accepts no responsibility for the social or environmental consequences of its actions.

[6]Anthony Sampson, *The Sovereign State of ITT* (New York: Stein and Day, 1973).

One of the most severe industrial tragedies in history involved a massive gas leak from a Union Carbide facility in Bhopal, India, in 1984, an accident that resulted in 18,000 deaths and 50,000 permanent disabilities. The company was fined $470 million, and criminal proceedings were initiated against its key executives. The case was finally resolved in Indian courts in 2010, but it was immediately appealed by the government, which felt that a sentence of two years in prison for seven Indian company executives was too lenient.[7]

Subsequent decades have been punctuated by similar disasters for which MNEs have been held responsible. Some, such as BP's 2010 Deep Horizon oil rig explosion in the Gulf of Mexico, have been highly publicized. Others, such as the ongoing series of spills in the Niger Delta—at least 50 times the impact of the 1989 Exxon *Valdez* oil spill, according to the World Wildlife Fund (WWF)—go largely unreported. Shell and Exxon claim that most have been the result of oil pipeline thieves and militant activists.

Because MNEs are able to operate outside the legal framework of any single government, some believe that they need to be better regulated and controlled. However, most supranational organizations and agencies (e.g., ILO, UNCTAD, and UNESCO) have been relatively ineffective in providing such oversight. As a result, many global NGOs have begun to assume the role of monitors and controllers of exploitive MNEs. As Nestlé, Nike, and Shell learned firsthand, these NGOs could exercise their power effectively through their ability to organize protests, boycotts, or political action, targeting the MNE's customers, stock owners, or regulators.

Not surprisingly, exploitive MNEs soon developed adversarial attitudes toward NGOs, and that relationship was reciprocated. Consider the example of the multinational tobacco companies that had been targeting developing country markets for decades as regulatory pressure and consumer education shrank their markets in the West. During the early 1990s, when the former Soviet Union split into several independent countries, the laws previously in place banning tobacco advertising, forbidding smoking in many public places, and requiring health warnings on cigarette packages were no longer binding in the newly created states. According to researchers, "post-transition, the tobacco companies exploited confusion over the legality of this Soviet legislation by advertising heavily to establish their brands."[8] Subsequent surveys indicated that in a part of the world where tobacco was already responsible for twice the number of deaths among men as in the West, there has been a significant increase in youth smoking.

The response from public health researchers and antismoking NGOs was loud and sustained. They lobbied various newly established governments to reestablish antismoking controls and worked actively to publicize the negative implications of MNE activities in the region. The tobacco companies countered by emphasizing the job creation and increased taxes available to local governments from the investments they have made.

The adversarial relationship between the groups continues. In 2011, when British American Tobacco (BAT) threatened to sue the Namibian government over its plan to require warning statements and photos on cigarette packages, NGOs from 50 countries

[7]See www.bhopal.com and www.responsiblecare.org.

[8]A. B. Gilmore and M. McKee, "Tobacco and Transition: An Overview of Industry Investment, Impact, and Influence in the Former Soviet Union," *Tobacco Control* 13 (2004), pp. 136–42.

banded together to communicate their support of the government's actions and their willingness to help it defend against what they described as BAT's "bullying."

Overall, the picture of the exploitive MNE is not a pretty one. It is an organization that is willing to collude with political elites, violate environmental norms, ignore the welfare of consumers and employees, and expose emerging market communities to potential harm. Fortunately, it seems to be a species in decline.

The Transactional MNE: Doing Deals, Respecting Laws

Although the examples cited in the previous section indicate that some companies still exhibit at least some elements of the exploitive MNE, there are few companies today that are still driven only by the objective of maximizing profit in the sole service of the shareholder. In the pure form articulated and advocated by economist Milton Friedman, this philosophy opposed corporations making any charitable donations or acting in response to any social issue. Today, most publicly owned corporations demonstrate at least a little charitable generosity and show at least some sensitivity toward their communities. And because of widespread public rejection of extreme profit maximization behavior, the minimum expectation of MNE behavior today tends to be based on what we describe as a "transactional attitude."

The difference between the transactional MNE and the exploitive one is that the former adopts an approach that is both legally compliant and non-oppressive in its emerging market dealings. Yet despite adopting a relationship with its environment that is almost exclusively commercial, the transactional MNE, unlike its exploitive counterpart, does not pursue the bottom line at all costs. Indeed, many companies that once were insensitive to the serious problems that their aggressive or indifferent attitudes created have evolved from their exploitive approach to adopt a more responsible transactional posture.

The transactional MNE's relationship with its emerging market customers avoids the egregious missteps highlighted in the Nestlé experience. This implies having the sensitivity to recognize that products originally developed for consumers with very different needs or markets with very different characteristics should not be promoted where they are socially, culturally, or economically inappropriate. Beyond this understanding, these companies are often willing to make minor product or service adaptations to meet local needs or preferences, but only if such a change is likely to expand market share, increase profits, or meet some other commercial need.

For example, global fast-food giants such as McDonald's and KFC are often willing to make minor changes to their product offering or service approach on a country-by-country basis, but they seldom stray very far from their standard menus. And although they are generally regarded as law-abiding, taxpaying corporate citizens in the countries in which they operate, they have also been accused of cultural insensitivity or worse. Particularly in the area of public health, many government agencies have expressed concern about the increasing health risks for people in developing countries who are being persuaded to change their eating habits from the high-fiber, natural foods of their local diets to the high-fat, refined foods that dominate fast-food menus.

With regard to employee relations, because the transactional MNE respects local labor laws and International Labor Organization (ILO) guidelines, it usually relates to

its employees in a much less brutal or oppressive way than the exploitive company. For example, the transactional MNE would not be willing to have its own employees, or those of its subcontractors, work in the sweatshop-like conditions that we described in the previous section. Yet, though they conform to labor laws and workplace regulations, these companies still would be likely to maintain pressure on employees and suppliers to capture the value of the lower-cost labor that attracted their original investment.

In one widely publicized recent example, Apple was forced to move some way along this learning curve in the face of growing reports of harsh working conditions in its suppliers' plants. For many years, Apple had sidestepped pressure from NGOs about labor practices employed in the manufacture of its products, arguing that it was the subcontractors, not Apple, that employed the workers. Finally, in response to pressure, it began publishing audits of factories where its products were sourced in 2007. But in May 2010, press reports that the ninth suicide of the year had occurred at a Foxconn factory in southern China producing Apple products sparked public outrage. In response, Foxconn put up safety nets to prevent suicide jumps from dormitories, improved factory conditions, and raised wages. But a year later, a watchdog group reported that Foxconn was forcing employees to work up to 100 hours a week without proper compensation.

To ensure greater compliance and transparency, Apple subsequently joined the Fair Labor Association (the first high-tech company to do so), and invited that nonprofit group to conduct inspections of its suppliers' factories. In its 2012 annual report on conditions in its suppliers' factories, Apple released the names of 156 companies that supplied it with parts and their compliance with its standards. Following the report and discussions with Apple, Foxconn raised the wages of workers by 25 percent and promised its employees that they would no longer have to work beyond the 49-hour workweek limit set by Chinese law.

In its attitude toward local communities and the broader society, the transactional MNE does not exhibit the same level of indifference and irresponsibility that characterizes the exploitive MNE. One lesson that transactional-oriented MNEs appear to have learned from the experiences of Nestlé in Africa, Union Carbide in Bhopal, and tobacco companies in the former Soviet Union is that it usually makes economic sense to obey both the letter and the spirit of local and international laws and regulations.

Evidence of this shift began appearing in the years following the signing of the North American Free Trade Agreement (NAFTA). Many had predicted that Mexico would become a pollution haven for MNEs with dirty chemical, metals, or paper plants hoping to take advantage of that country's low environmental standards or lax enforcement. Yet more than a decade later, careful research has concluded that "no discernible migration of dirty industry has occurred."[9] The fact that there has been no such large-scale migration to Mexico of companies fleeing tightening U.S. regulations tends to suggest that most MNEs have established a law-abiding, non-exploitive attitude toward emerging markets.

At a minimum, the transactional-oriented MNE takes the equivalent of a Hippocratic oath to communities. (The ancient Greek physician Hippocrates is credited with the

[9]Gustavo Alanis-Ortega, "Is Global Environmental Governance Working?" *The Environmental Forum*, May/June 2006, p. 23.

expression "First, do no harm," which forms part of the oath taken by physicians.) Such an attitude applied to MNEs increases the likelihood that the worst potential corporate abuses will be avoided, but that does not mean that transactional MNEs will be fully trusted or that their actions will not be carefully monitored by regulators or NGOs. And in recent years, it has often been the global NGOs that have taken the more active role in pushing MNEs to take more responsibility for their social, economic, and environmental impact.

Take the case of Nike. Despite the major concessions that the company made to the NGOs' demands in the late 1990s—for example, to increase its working minimum age for footwear manufacture from 14 to 16, and eventually to 18—it was clear that NGOs would remain interested in the company's practices simply because Nike is a highly profitable, highly visible industry leader, dealing with 700 factories that collectively employ over half a million people, mostly in emerging markets. But Nike's relationship with the many NGOs with which it sparred in the mid-1990s has slowly changed. Although some remnants of the activist-driven boycotts and protests remain, the heat has been greatly reduced. As the company moved to comply with more of their demands, the NGOs' role evolved from active adversary to vigilant watchdog.

Although not always enthusiastically embracing each other, this relationship between NGOs and transactional companies is based less on confrontation and accusation and more on monitoring and challenging. And while the NGOs might agree that "doing no harm" is certainly a positive characteristic, they also challenge companies to consider whether that is a sufficient role for the multinational enterprise of the 21st century.

The Responsive MNE: Making a Difference

In the past, a large number—perhaps a majority—of MNEs might have exhibited behavior that was significantly or even predominantly exploitive or transactional, as we have described those behaviors. In recent years, however, management's concept of a sustainable strategy has migrated from a passing acknowledgment of the need to develop a responsible corporate environmental policy to a recognition that companies must articulate a philosophy that reflects their long-term viability as participants in and contributors to the broader social and economic environment. This perspective requires managers to take a broader view of their constituencies and their roles and responsibilities in the societies in which they operate.

A 2006 McKinsey study supports the notion that executives around the world are becoming more aware of their larger responsibilities and increasingly convinced that they have a broader role to play. The McKinsey survey of 4,238 executives from 116 countries found that only 16 percent of respondents saw their responsibility as being to focus on the maximization of shareholder returns, whereas 84 percent expressed the opinion that high returns to shareholders must be balanced with contributions to a broader good.[10]

The responsive MNE, as we have dubbed it, reflects this view and undertakes to be more than just a law-abiding entity: it makes a conscious commitment to be a contributing corporate citizen in all the environments in which it operates. In contrast to its exploitive

[10] "McKinsey Global Survey of Business Executives: Business and Society," *McKinsey Quarterly*, January 2006, available at http://www.mckinseyquarterly.com/article_page.aspx?ar=1741&L2=39&L3=29.

and transactional counterparts, the responsive MNC is more sensitive to the different needs of the stakeholders in developing countries and manifests this behavior more proactively in the way in which it deals with its customers, employees, and the community at large.

In his book *The Fortune at the Bottom of the Pyramid,* C. K. Prahalad argues that MNEs have a responsibility to contribute to development in the poorest nations of the world. In his words, "Big corporations should solve big problems." But he also made the case that in doing so, they can avail themselves of a huge opportunity to access a largely untapped market of 4 billion people. By investing in developing markets, creating jobs, generating wealth, and catering to underserved consumers, Prahalad argued that MNEs have an opportunity to bring into the marketplace millions of consumers from the two-thirds of the global population that earns less than $2,000 per year.[11]

Some companies have understood this opportunity for decades, none more so than Hindustan Lever. As Unilever's operating company in India for more than a century, this company has long understood that the key to developing scale and driving growth in that densely populated country is to expand its target market well beyond the middle- and upper-class consumers that are the typical focus of most MNEs in India. For many decades, Hindustan Lever has aimed at expanding its operations to serve the rural poor by adapting the company's products and technologies to their very different needs and economic means. For example, it developed a way to incorporate Unilever's advanced detergent technology into simple, laundry bars, thereby providing superior washing capabilities in the cold-water, hand-washing methods that characterize India's widespread practice of doing laundry in the local stream or village washhouse. The company also adapted to local economic realities and social structures by selling through small rural shops and a network of 50,000 *shakti* women who make a living on sales commissions earned by selling products from their homes in remote villages.

Even in sophisticated product markets such as medical diagnostic equipment, there is the opportunity for MNEs to adopt a more responsive approach that can bring advanced technology to developing countries. For example, GE Healthcare invested $60 million in its Indian R&D center to develop a range of diagnostic products adapted to the simpler needs and more cost-constrained budgets of developing country health care systems. Although the economy model of its computed tomography (CT) scanner sells for about 40 percent less than the price of the advanced models in the United States, the potential for such a product in less developed markets is huge. The company is currently adapting its latest positron emission tomography (PET)—CT scanners that provide improved diagnosis for cancer, heart disease, and brain disorders—and it plans to have a system costing 30 percent to 40 percent less than current models by 2014.

To meet the needs of this large, previously unserved market, GE has gone beyond the adaptation of its current line to create a business it calls its Gold Seal Program. Through this program, the company acquires used x-ray machines and CT scanners, refurbishes them to their original specifications, and then resells them to developing-country markets. Although these may not be the latest models with the most up-to-date technological features, they are in high demand, and GE's initiative has earned it a

[11] C. K. Prahalad, *The Fortune at the Bottom of the Pyramid* (Upper Saddle River, NJ: Wharton School Publishing/ Pearson, 2005).

30 percent share of a $1 billion global market for refurbished diagnostic equipment. Better still, the market is growing at 15 percent per year.

But the responsive MNE accepts a role beyond that of a commercial participant in developing countries' economies, no matter how flexible and responsive. These companies also feel the responsibility to be good corporate citizens that have a positive impact on those whose lives they touch. For example, Starbucks has accepted the responsibility to help its farmer suppliers obtain higher prices for their coffee while simultaneously enhancing local environmental and labor practices. In 2004, it collaborated with Conservation International to create its Coffee and Farmer Equity (CAFE) practices, which proposed key points of a new agreement between Starbucks and the farmers. In return for compliance with labor and environmental standards independently set and monitored by Conservation International, farmers who meet CAFE standards would be offered "preferred supplier" status, including long-term contracts and a price premium. In 2011, 86 percent of Starbucks' coffee supply—367 million pounds worth $875 million—came from farms that followed its CAFE guidelines.

Many of the actions of these and other responsive MNEs reflect the aspirational standards of behavior contained in the voluntary Global Compact, signed by more than 8,600 companies from 130 countries in the years since its introduction in 1999 at the World Economic Forum in Davos by Kofi Annan, then Secretary General of the United Nations (U.N.).[12] (See Exhibit 8-1 for a summary of the key principles of the Global Compact.) Although it is a voluntary, self-regulated set of aspirational norms rather than a legislated and enforceable code, the Global Compact seems to represent a way

Exhibit 8-1 The Global Compact's ten principles

Human Rights

1. Businesses should support and respect the protection of internationally proclaimed human rights; and
2. make sure that they are not complicit in human rights abuses.

Labour Standards

3. Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
4. the elimination of all forms of forced and compulsory labor;
5. the effective abolition of child labor; and
6. the elimination of discrimination in respect of employment and occupation.

Environment

7. Businesses should support a precautionary approach to environmental challenges;
8. undertake initiatives to promote greater environmental responsibility; and
9. encourage the development and diffusion of environmentally friendly technologies

Anti-Corruption

10. Businesses should work against all forms of corruption, including extortion and bribery.

Source: www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/index.html

[12]More recently, the Global Compact has helped establish the Principles for Responsible Management Education (PRME). Its mission is to "inspire and champion responsible management education, research, and thought leadership globally."

forward that can encourage MNEs to embrace a more responsive and constructive role in the developing world.

The Transformative MNE: Leading Broad Change

In recent years, there has been a growing number of examples of private sector organizations not only being sensitive and responsive to the problems and needs of the developing world, but also taking the lead in broad-scale efforts to deal with their root causes. Because of the cost and commitment required to take such action, it is hardly surprising that the boldest and most visible of such initiatives have been those taken by private individuals and/or their foundations. Highly visible current era global philanthropists like Bill Gates and George Soros have created foundations that have committed billions of dollars to attacking some of the biggest problems of health, education, and welfare among the world's neediest populations.

Several large companies have also stepped up to the challenge. Despite the huge commitment required, these pioneering transformative MNEs are leading major initiatives to help deal with problems facing the developing world. Beyond being good corporate citizens, they have concluded that they can and should take a larger role in the less advantaged countries in which they operate by bringing their resources to bear on the massive problems that the populations and governments of these countries face.

Most transformative MNEs evolve to this high level of commitment from the more modest business-linked activities that characterized those companies we described as responsive MNEs. For example, Heineken responded to the AIDS epidemic in Africa in the 1990s when it created a prevention and education program for its 6,000 African employees. In 2001, the company expanded the program to offer free antiretroviral drugs to all infected employees, later extending the benefit to cover all of their family members. In subsequent years, Heineken continued expanding its clinics which by 2007 provided care to 30,000 HIV-positive patients. The subsequent formation of the Heineken Africa Foundation allow it to extend its programs to a variety of prevention, treatment, and research programs in eight sub-Saharan African countries.

Another company whose recent commitments have vaulted it into the transformational MNC category is Unilever. Its Sustainable Living Plan provides a commitment that by the year 2020, the company will improve the health and well-being of 1 billion people worldwide, will cut the environmental impact of its products by 50 percent, and will source 100 percent of its agricultural products from sustainable producers. The bold plan is broken into more than 60 social, economic, and environmental targets, each of which is monitored and reported on annually. Early progress has been impressive. In 2011, the first year of reporting, a sampling of reports on the 60 metrics showed that the company had reached 100 million people with its hand washing and oral care programs and 35 million with the safe drinking water project; it had increased its percentage of sustainably sourced raw materials from 14 percent to 24 percent; and it had engaged with 500,000 small farmers and 75,000 small-scale distributors worldwide to bring them into the program. Paul Polman, Unilever's CEO, explained that he simply believed that this is the way responsible companies should act: "I'm not interested whether the plan brings competitive advantage... It's the only way to do business in the long term."

Because they often deal with long-term problems or challenge deeply embedded practices, such transformational programs can be difficult to implement, particularly when social and economic environments are governed by very different cultural norms and legal frameworks. As a result, it often requires a long process of learning, adaptation, and above all, commitment to achieving results. One of the most sustained examples of transformational change has been Merck's commitment to eradicate river blindness, a disease that exists almost entirely in the developing world. When the pharmaceutical giant developed a drug to prevent river blindness in 1987, it recognized that few of the more than 18 million sufferers of this debilitating disease or the 100 million who were at risk could afford the treatment. So the company decided to make the drug freely available for as long as it was needed to anyone suffering from or at risk of becoming exposed. Over the past 25 years, in partnership with numerous U.N. and governmental agencies, NGOs, and local communities, the program has delivered Mectizan tablets without charge to treat more than 700 million patients in Africa and South America. It currently reaches 100 million people annually and prevents an estimated 40,000 cases of blindness each year.

As the preceding examples have shown, in implementing these activities, MNEs often find themselves working in partnership with NGOs or supragovernment agencies that can provide expertise in social program delivery that the companies typically lack. In doing so, they develop very different relationships with these groups than the adversarial or defensive exchanges that characterize exploitive or transactional MNEs' experiences with such organizations. It is a partnership leverages the resources and capabilities of both groups and may well prove to be the engine that can drive the changes that have been so elusive in attempts to accelerate economic and social development in the world's poorest nations. If so, it will create a future role for the MNE that will make it an even more important and respected player on the world stage.

Concluding Comments

Over time, there has been an evolution in the roles, responsibilities, and expectations of MNEs operating in host countries around the world. In his seminal books *Sovereignty at Bay* and *Storm over the Multinationals,* both published in the 1970s, Harvard Professor Ray Vernon expressed concerns about the "economic hegemony and economic dependence" that often characterized the relationship between MNEs and host-country governments in the developing world in that era.[13] And various corrupt or exploitive acts by those companies during this time period created what Vernon described as a sense of "tension and anxiety on the part of many nation-states."

As the anecdotes that open this chapter illustrate, MNEs are still susceptible to charges of insensitivity and irresponsibility. But in the three decades since Vernon's research was published, the concern that MNEs were holding "sovereignty at bay" has gradually subsided. And although there has been little success in creating the effective supranational agencies that once were thought vital to reining in the unfettered power of the MNE, the rise of numerous, highly effective global NGOs has filled the role of

[13]Raymond Vernon, *Sovereignty at Bay* (New York: Basic Books, 1971); Raymond Vernon, *Storm Over the Multinationals: The Real Issues* (Cambridge, MA: Harvard University Press, 1977).

the active "watchdog." As the several examples cited in this chapter show, NGOs have become very effective at using their clout with consumers, shareholders, and other company stakeholders as a way to bring about change.

But the biggest change has occurred in the evolving attitudes of companies toward their sense of corporate social responsibility and their commitment to a strategy of sustainability. Although a few firms have remained stuck in an exploitive mode, most have adopted, at a minimum, a transactional approach. And with the growing influence of public, government, and NGO demands, and increasingly rising shareholder expectations, the trend is clearly moving toward responsive and even transformative models.

The social needs in emerging markets are great, and MNEs and their managers are feeling both pressure and encouragement to respond. In addition to transforming the lives of those at the "bottom of the pyramid," their commitment of resources to such activities may very well represent one of the most important investments that the MNE will ever make.

Chapter 8 Readings

- In Reading 8-1, "A Global Leader's Guide to Managing Business Conduct," Paine, Deshpandé, and Margolis use the results of a large-scale survey to challenge multinational corporations to reconsider their current internal standards of business behavior. Their findings suggest that there is surprising agreement on what those standards should be, as well as a consensus that companies are falling short of their basic responsibilities in the international environment. They provide guidance on the development and monitoring of an appropriate set of standards.
- In Reading 8-2, "Serving the World's Poor, Profitably," Prahalad and Hammond detail how multinationals can build businesses aimed at the bottom of the economic pyramid in order to build competitive advantage. They argue that such investments in the world's poorest markets can result in both tangible business benefits and major contributions to poverty reduction.

The roles and responsibilities of the MNE continue to evolve, as these readings suggest. MNEs have much to contribute.

MNE/Stakeholder Relationships in Emerging Markets: A Typology

MNE Responses and Attitudes	Stakeholders: Economic — Shareholders	Economic — Customers	Economic — Employees/ Suppliers	Societal — Local Communities	Political/Regulatory — Government and Supranational Agencies/ Regulators (e.g., U.N. Agencies)	Political/Regulatory — NGOs
Exploitive *Views differences in wages, working conditions and living standards as exploitable opportunities.*	Adopts classic Milton Friedman view: Its only legitimate role is to maximize returns to shareholders.	Sells existing products and services, even if they have negative social or economic impact.	Exploits existing local wages, working conditions, and suppliers, driving them lower if possible.	Accepts no community responsibility for its social or environmental impact.	Seeks concessions and subsidies, using bargaining power to play national investment boards against each other. If bribery and corruption exist, engages in local practices to win benefits.	An adversary: NGOs actively work to force the MNE to change its behavior through protests, boycotts, political activism, etc.
Transactional *Engages in law-abiding, nonexploitive, commercial interactions.*	Focus on shareholder returns, but believes a pure Friedman approach is inconsistent with the long-term interests of its shareholders.	Treats it as any another market. Makes product adaptations if they are economically viable and can increase market share.	Complies with local labor laws and workplace regulations. Uses cost-efficient local sources, pressuring them on price.	Adopts a Hippocratic Oath approach toward communities: (i.e., "First, do no harm").	Obeys local laws and regulations but uses country differences to gain competitive advantage.	A watchdog: NGO monitors the MNE's actions, urging or pushing it to do more.

Stakeholders

	Economic			Societal	Political/Regulatory	
	Shareholders	**Customers**	**Employees/ Suppliers**	**Local Communities**	**Government and Supranational Agencies/ Regulators (e.g., U.N. Agencies)**	**NGOs**
Responsive						
Acts in a way that is sensitive and responsive to the needs of all its immediate stakeholders.	Feels a responsibility to be a "good corporate citizen" in the environments in which it operates.	Invests in potentially significant product or service developments and/or adaptations to meet local needs.	Committed to caring for its employees and developing their skills. Actively engages local sources, using its buyer power to improve working conditions for employees.	Aims to affect positively those whose lives it touches in communities in which it operates.	Sets its standard of behavior above minimum local legal requirements. Conforms to higher international standards (e.g., set by ILO or UNESCO).	An observer: NGO may be neutral or partially engaged with MNE. Limited mutual trust.
Transformative						
Commits to leading initiatives to bring life-enhancing changes to the broader society.	Persuades investors of the need for companies to be part of the solution by bringing their resources to bear on the root causes of problems.	Believes that by helping move people out of poverty, it will create stability and goodwill and help grow the world's customer base. Develops products or services specifically to meet local needs.	Committed to upgrading the lives of its employees, inside and outside the workplace. Brings work standard–compliant local suppliers into global supply chain networks.	Leads in developing the quality of life in the broad community (e.g., upgrading health, education).	Actively raises local standards (e.g., transferring developed world workplace health and safety standards.) Supports change agenda of international agencies (e.g., WHO, UNESCO).	A partner: NGO works with and supports the MNE working toward the same objectives.

Case 8-1 Barrick Gold Corporation—Tanzania[1]

Aloysius Newenham-Kahindi and Paul W. Beamish

By March 2009, Canadian mining company Barrick Gold Corporation (Barrick) had only been operating in the Lake Victoria Zone in Tanzania for a decade. In the same year, Barrick had adopted a new name for its business in Tanzania, African Barrick Gold plc (ABG), which was also listed on the London Stock Exchange. The company was widely considered to be one of the more "responsive" global corporations in the mining industry.[2] Its extensive mining activities in the region employed thousands of local people, and Barrick was engaged in social development projects in various Tanzanian communities.[3] By October 2010, the company operated four main gold mining sites in the country.[4]

Despite Barrick's efforts to support social development initiatives in the Lake Victoria Zone over the past decade, discontent and resistance at one of its mining sites in North Mara still remained. This area posed challenges. A key question was why the tension and violence had not stopped in certain mining sites in the North Mara mining area, and whether there was much more Barrick could reasonably be expected to do to resolve the problem.

IVEY

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Professors Aloysius Newenham-Kahindi and Paul W. Beamish wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

[1]This case has been written on the basis of published sources only. Consequently, the interpretation and perspectives presented in this case are not necessarily those of Barrick Gold Corporation or any of its employees.

[2]www.barrick.com/CorporateResponsibility/BeyondBorders/default.aspx, accessed March 24, 2009.

[3]www.barrick.com/News/PressReleases/PressReleaseDetails/2010/Barrick-Named-to-Dow-Jones-Sustainability-World-Index-for-Third-Consecutive-Year/default.aspx, accessed September 27, 2010.

[4]www.tanzaniagold.com/barrick.html, accessed October 1, 2010.

Background on Tanzania

Tanzania was a developing country located in East Africa, with a total land size of 945,087 square kilometres. It had one of the highest levels of unemployment and poverty in Sub-Saharan Africa. Its economy was heavily dependent on agriculture, which accounted for half of the gross domestic product (GDP), provided 85 per cent of the country's exports and employed 90 per cent of the work force. Topography and climatic conditions, however, limited cultivated crops to only four per cent of the land area. Industry was mainly limited to processing agricultural products and light consumer goods.

Like most developing nations, Tanzania had a very weak national institutional and legal system. It also had a very high rate of corruption.[5] The country needed support from foreign direct investment (FDI) and transnational corporations (TNCs) in order to promote businesses, employment, and other opportunities for its citizens. Tanzania wanted its institutions to be more transparent and accountable, and to regulate the activities of FDI and TNCs in addressing the country's social and ecological issues. Both local and international not-for-profit organizations (NFOs), however, had continued to create a significant impact with respect to promoting responsive behaviour in corporate governance practices, positively influencing all involved stakeholders and other social actors to address social issues.

Following independence in 1961, Tanzania opted for a socialist command economic and institutional system, with socialist policies ("*Ujamaa*" in Swahili) being implemented in 1967. The emphasis of these

[5]*See data on Tanzania at* www.transparency.org.

policies was to promote co-operative institutions and collective villages with the aim of building an egalitarian society, eliminating ethnic and gender barriers, and creating a common language of Swahili for all. Within the practice of Ujamaa, the country had managed to unite its ethnic groups under a common language, with the result that the central government had created strong post-colonial nationalistic ideologies, unity, ethnic harmony and peace among its people. Compared to many post-colonial Sub-Saharan African countries that went through civil and ethnic strife and conflicts after independence in the 1960s and 1970s, Tanzania under Ujamaa appeared to be a successful model.

Towards the end of the 1980s, however, Tanzania began to experience significant economic stagnation and social problems. To combat these issues, in the early 1990s the government sought to privatize its economy and reform its institutions in order to attract foreign investment. The introduction of the famous post-Ujamaa Investment Act of 1997 was intended to encourage free market and trade liberalization in the country. Investment in various private sectors such as mining, tourism, fishing, banking and agriculture under foreign-owned TNCs served to bolster the country's reforms by creating employment opportunities for the local economy.

As the country continued to privatize and reform its national institutional and legal systems, many foreign companies sought to invest in its economy. The Tanzania Investment Centre (TIC) was created in the early 2000s as a tool for identifying possible investment opportunities and aiding potential investors in navigating any procedural barriers that might exist during the process of investment in the country.[6] The liberalization of the banking industry in 2002, for example, saw the former Ujamaa Cooperative and Rural Development Bank replaced by the Commercial Rural Development Bank (CRDB) and the National Microfinance Bank (NMB), which promoted community investments across the country. In February 2009, the Tanzania Private Sector Foundation (TPSF) was created with the aim of strengthening the entrepreneurial culture among its citizens by providing communities and individuals across the country with entrepreneurial business ideas and grants. In June 2009, the government started an ambitious national resolution under the so-called "Kilimo Kwanza" policies (meaning "Agriculture First" in Swahili) to boost the standard of living among the *eighty per cent* of citizens who relied on agriculture for their livelihood.[7] It was based on Green Revolution principles aimed at boosting Tanzania's agriculture into the modern and commercial sector, and mobilizing for-profit organizations (FPOs) such as local private businesses and foreign-owned TNCs in the country to increase their investment engagement with the agriculture sector, both at the macro and micro levels (i.e. along with local communities).

In order to ensure that there was sufficient security and peace for private and foreign-owned investors (i.e. TNCs), in 2005 the government introduced a new entity called "Tanzania Security Industry Association." The association was based on local, professional private security firms and groups whose main tasks were to safeguard business firms' activities rather than letting the firms rely on local police forces. The largest and best-known local security firm was "Moku Security Services Limited," based in Dar Es Salaam, which had over 13,000 employees across the country. Other security groups with over 400 employees were "Ultimate Security Company," "Dragon Security," "Tele-security Company Limited," and "Group Four Security Company." Private security employees were mainly retired army and police officers; young people who had lost their previous jobs following the collapse of the Ujamaa policies that provided "jobs for everyone and for life"; and individuals who sought better remuneration in the security sector than in the government public sector. However, due to increased demand for better security across businesses, many foreign-owned TNCs sought the services of security firms from abroad, mainly from South Africa's professional security firms such as the South African Intruder Detection

[6] www.tic.co.tz, accessed April 1, 2009.

[7] www.actanzania.org/index.php?option=com_content&task=view&id=121&Itemid=39, accessed February 12, 2010.

Service Association (SAIDS). Some security personnel had combat experience, which helped them handle sophisticated forms of crime and intrusion.

The Tanzanian economy continued to grow and create job opportunities, training and innovative development prospects for its people. Earlier, the country had introduced new mining legislation such as the Mining Act of 1998 and the Mining Regulation Act of 1999 in order to harmonize investment relations between FDI and local interests. However, in April 2010 the government passed another new mining Act, following consultations with civil society groups such as the Foundation for Civil Society Tanzania (FCST), companies and other stakeholders. The legislation of a new mining Act imposed a new form of royalties that required all TNCs and local companies to be listed in the country and gave the state a stake in future projects.[8]

The country possessed vast amounts of natural resources like gold, diamond, copper, platinum, natural gas, and zinc deposits that remained underdeveloped. It was one of the more peaceful countries in Sub-Saharan Africa. In order to attract and protect the interests of FDI and TNCs and, of course, its own people, Tanzania had attempted to harmonize its investment practices and labour legislation. In order to create responsible institutional policies, in February 2010 the National Assembly of Tanzania enlisted a group of local environmental and toxicity experts to investigate environmental and toxic effects on the people and livestock in the North Mara gold mine in Tarime District, Mara Region, by the Tigithe River.[9]

For a number of reasons, Tanzania was a willing host nation for FDI. The country needed the input of TNCs in order to create employment and prosperity. In return, Tanzania could provide TNCs with low-cost labour and a readily available labour force. Low labour costs were an opportunity to support a host nation's development policy in attracting FDI and ultimately in creating a knowledge-based society in the midst of the globalization challenges that were faced by so many developing countries. Furthermore, Tanzania continued to create a local business environment in conjunction with various TNCs' global business interests in order to generate sustainable development policies and practices. It also engaged in market development initiatives that represented innovative learning opportunities and entrepreneurship ventures for its citizens.

[8]www.mining-journal.com/finance/new-tanzanian-mining-act, accessed September 27, 2010.

[9]www.dailynews.co.tz, accessed February 10, 2010.

Lake Victoria Background

Tanzania's Lake Victoria was surrounded by the three East African countries of Kenya, Tanzania and Uganda. The lake itself was named after the former Queen of England, Queen Victoria, and stood as the world's largest tropical lake and the second-largest freshwater lake after Lake Superior in North America. Covering a total of 69,000 square kilometres, the lake was as large as the Republic of Ireland and lay in the Rift Valley of East Africa, a 3,500-mile system of deep cracks in the earth's crust, running from the Red Sea south to Mozambique. Lake Victoria was the source of the Nile River, which passed through the Sudan and Egypt and finally reached the Mediterranean Sea.

Lake Victoria Zone in Tanzania The Lake Victoria Zone consisted of the three regions of Mwanza, Mara (formerly called Musoma) and Kagera (formerly called Bukoba), and was one of the most densely populated regions in Africa. Population growth around Lake Victoria was significantly higher than in the rest of Sub-Saharan Africa. During the last five decades, population growth within a 100-kilometre buffer zone around the lake had outpaced the continental average, which had led to growing dependency and pressure on the lake's resources.

Prior to the mining extraction boom in the early 1990s and following the collapse of Ujamaa, most people living in this region were mainly engaged in rudimentary forms of fishing, agricultural farming and keeping cattle, as well as other forms of co-operative activities that had been engineered by the country's former Ujamaa policies. Irrigation was limited to a small scale and often used rudimentary technologies to support both individual

and co-operative farming activities. Noted for its temperate climate, the area had a mean temperature of between 26 and 30 degrees Celsius in the hot season and 15 and 18 degrees Celsius in the cooler months. The area was rich with tropical vegetation and fruits such as bananas, mangoes, corn, pineapple and many others. The lake was essential to more than 15 million people, providing potable water, hydroelectric power, and inland water transport, as well as support for tourism and wildlife.

The area remained one of the most fertile for farming activities and continued to attract immigrants from other regions of the country, as well as from Tanzania's neighbors in the war-torn populations of Burundi, Rwanda and the Democratic Republic of Congo. The presence of hundreds of TNCs engaged in various activities in the area was the main "draw" for these immigrants, who came seeking employment and new sources of livelihood.

The resulting population increase in the Lake Victoria Zone created several problems with respect to the lake and the environment. According to a report by World Watch Institute in Washington, D.C., the once clear, life-abounding lake had become murky, smelly and choked with algae. It had been reported that:

> The ecological health of Lake Victoria has been affected profoundly as a result of a rapidly growing population, clearance of natural vegetation along the shores, a booming fish-export industry, the disappearance of several fish species native to the lake, prolific growth of algae, and dumping of untreated effluent by several industries. Much of the damage is vast and irreversible. Traditional lifestyles of lakeshore communities have been disrupted and are crumbling.[10]

As a result of the overuse of natural resources in the area, the traditional lifestyles of the lakeshore communities were significantly disrupted, a situation that prompted both social and ecological concerns for the area and its residents.

The fishing industry was badly affected in the region following the introduction of Nile perch (Lates Niloticus) and Nile tilapia (Oreochromis Niloticus) into the lake. For example, in the 1980s a survey of the lake revealed an abrupt and unexpected increase in numbers among the Nile perch, constituting 80 per cent of all fish in the lake. In spite of working harder, local fishermen caught fewer fish since the populations of smaller fish, which traditionally had been the fishermen's primary source of livelihood, became decimated. In addition, the big oily Nile perch, generally referred to as "Mbuta," swam too far out in the open waters for the little local fishing boats and was too big to be caught in the locals' unsophisticated nets.

In response to an increased international demand for the Nile perch, commercial fishing fleets owned by foreign firms displaced local fishermen and many women in lakeside communities who worked as fish processors. The processing of fish, traditionally performed by women, was gradually taken over by large filleting plants. The women resorted to processing fish waste, commonly referred to as *mgongo-wazi*, or "bare-back" in Swahili. The waste, comprised of fish heads, backbones and tails, was sun-dried and then deep-fried and sold to local people who were drawn to its low price and nutritional value. Many fishermen were forced to look for alternative sources of livelihood, mainly seeking employment in extractive mining corporations and other industries as manual labourers.

The water hyacinth posed another threat to the health of Lake Victoria. With the deceptive appearance of a lush, green carpet, the hyacinth was in fact a merciless, free-floating weed, reproducing rapidly and covering any uncovered territory. First noticed in 1989, the weed spread rapidly and covered areas in all three surrounding countries. It formed a dense mat, blocking the sunlight from reaching the organisms below, depleting the already-low concentrations of oxygen and trapping fishing boats and nets of all sizes. The hyacinth was also an ideal habitat for poisonous snakes and disease-carrying snails that caused bilharzias. The government, in partnership with other international agencies, had tried desperately to control the weed. Its most promising approach involved harvesting the hyacinth and using it either for compost or for biogas production.

The health implications associated with the declining state of the lake were extensive. Dumping

[10] www.cichlid-forum.com/articles/lake_victoria_sick.php, accessed April 1, 2009.

untreated sewage in the lake and nearby rivers exposed people to waterborne diseases, such as typhoid, cholera and diarrhea, and chronic forms of malaria. The Lake Victoria Zone was known to have the most dangerous types of malaria in the world. As fish prices soared, protein malnutrition became a significant threat for communities living in the zone. Lack of regular income also meant that many people in the area could not afford to be treated for waterborne typhoid, yellow fever, and various forms of tropical worms such as tapeworms and hookworms.

Mining in Tanzania Gold mining activities around the Lake Victoria Zone in Tanzania started during the German colonial period in 1894, when Tanzania was called Tanganyika. The First and Second World Wars accelerated the demand for gold production in the region and, following the introduction of Ujamaa in 1967, mining became a state-directed activity. By nationalizing the industry, the government hoped to capture more benefits from mining through the creation of local employment, direct spending on social services for mining communities, and higher budget revenues from having a direct stake in the business. However, despite these high hopes, the mining sector failed to stimulate the industrialization of the country's economy. During Ujamaa, the production of gold declined significantly due to limited government funding and limited technological know-how within the industry. Mining activities that were performed illegally by small-scale operators contributed to several environmental and social problems.[11]

The collapse of Ujamaa in 1990s, however, resulted in new opportunities for the country to attract mining companies from Canada, the United Kingdom, Australia and South Africa, all of whom were interested in gold exploration and development activities. Following successful exploration mining activities that began in 1995, Barrick invested in Tanzania in 1999 at the Lake Victoria Zone. It acquired gold reserves in the Bulyanhulu mine, located in northwest Tanzania, East Africa, approximately 55 kilometres south of Lake Victoria and approximately 150 kilometres from the city of Mwanza; Buzwagi near Kahama District; Tulawaka in Biharamulo, Kagera Region; and later at the North Mara gold mine in the northwestern part of Tanzania in Tarime District of Mara Region, approximately 100 kilometres east of Lake Victoria and 20 kilometres south of the Kenyan border.

According to the Tanzanian Mineral Authority and Tanzania Chamber of Minerals and Energy (TCME), since 2000 production of gold had been growing, making the Lake Victoria Zone one of the most attractive areas for employment opportunities as well as for business opportunities in other industries. Tanzania was Africa's third-largest producer of gold, after Ghana and South Africa.[12] Tanzania was also richly endowed with other minerals, including cobalt, copper, nickel, platinum group metals, and silver, as well as diamonds and a variety of gemstones. The energy sector was dominated by natural gas. Commercial quantities of oil had yet to be discovered. In 2008, TCME reported that a total of US$2 billion in the past decade had been injected into the Tanzanian economy by mining TNCs, and in total mining TNCs had paid the government over US$255 million in taxes within the same period.[13]

In 2002, Tanzania joined the African Union's development blueprint, an endeavour that was governed by the New Economic Partnership for African Development (NEPAD), to oversee an African Mining Partnership (AMP) with global mining corporations. The goal of this partnership was to promote sustainable development and best-practice guidelines for African governments as a way to ensure that their mining laws protected ecological and community welfare while maximizing remittances from the mining TNCs to the government budgets in a transparent and accountable way.

The country did, however, develop competitive tax packages and incentives to attract TNCs to

[11]www.douglaslakeminerals.com/mining.html, accessed February 26, 2009.

[12]www.mineweb.co.za/mineweb/view/mineweb/en/page67?oid=39782&sn=Detail, accessed May 1, 2009.

[13]Ibid.

Exhibit 1 Three Types of Engagement Behaviors

Dimension	Transactional	Transitional	Transformational
Corporate Stance	"Giving Back" Community Investment	"Building Bridges" Community Involvement	"Changing Society" Community Integration
Communication	One-Way	Two-Way	Two-Way
# of Community Partners	Many	Many	Few
Nature of Trust	Limited	Evolutionary	Relational
Frequency of Interaction	Occasional	Repeated	Frequent
Learning	Transferred from Firm	Transferred to Firm	Jointly Generated
Control over Process	Firm	Firm	Shared
Benefit & Outcomes	Distinct	Distinct	Joint

Source: F. Bowen, A. Newenham-Kahindi and H. Irene, "Engaging the Community: A Synthesis of Academic and Practitioner Knowledge on Best Practices in Community Engagement," *Canadian Research Network for Business Sustainability, Knowledge Project Series, Ivey School of Business*, 1:1, 2008, pp. 1–34.

invest in high-risk and complex exploration areas such as the Lake Victoria Zone. The government did not devise a practical and engaging strategy to utilize mining resources and revenues paid by TNCs to support the local communities that were situated around mining sites and who had lost their livelihood, homes, health, natural resources and recreation with little or no compensation.[14] Also, the government did not come up with a concrete strategy to deal with the chronic sewage and environmental issues in the area.

Like any TNC engaged in extractive mining activities in a developing country such as Tanzania with so many social problems and legal and institutional weaknesses, Barrick had faced conflicting pressures with regard to the way it engaged in locally based community social partnership (see **Exhibit 1**). Such partnerships were meant to address the social problems of unemployment, poverty, diseases and environmental concerns in a sustainable way. Barrick strictly followed Western legal and property approvals to legitimize its mining activities in the country. It also continued to face challenges with respect to its efforts to strike a balance between its global strategies and those of the local subsidiary operations in Tanzania. Mineral wealth continued to fuel and prolong violent behaviour by local communities mainly in North Mara, thus failing to diversify economic growth and contribute to the development of communities in the Lake Victoria Zone. Corruption and weak institutional capabilities to enact or enforce the democratic, transparent and agreed-upon rules and laws that governed the operation and taxation of mining activities were a source of ongoing problems.[15] Also, some local communities did not see the potential benefits of large corporations in their communities.

Barrick Gold Corp in Tanzania

As a gold producer on the world stage, Barrick used advanced exploration technological systems for its mining development projects.[16] The company owned one of the world's largest gold mineral reserves and a large land position across its subsidiary mining extraction activities. These were located across the five continents of North America, South America, Africa, Australia and Asia. As one of the largest Canadian mining companies, Barrick shares were traded on the Toronto and New York

[14]"The Challenge of Mineral Wealth in Tanzania: using resource endowments to foster sustainable development," International Council on Mining & Metals, 2006.

[15]www.revenuewatch.org/our-work/countries/tanzania.php, accessed May 1, 2009.

[16]www.tanzaniagold.com/barrick.html, accessed, May 1, 2009.

stock exchanges and on other major global stock index centres in London, as well as on the Swiss Stock Exchanges and the Euronext-Paris. It was a shareholder-driven firm. Barrick invested in Tanzania in 1999, following the completion of exploration activities that had started in 1995. The company's initial mining activities were limited to Bulyanhulu in Kahama Dictrict until 2004, when it expanded to other areas surrounding the Lake Victoria Zone.

Socialization was part of the corporate culture used to manage human resources (HRM)[17] in Tanzania. Each mining site had a training department. Barrick recruited university graduates who worked on administrative activities in corporate offices, and assigned manual labourers to mining sites to work along with expatriates and locals who had experience in mining activities. Also, the company was involved in developing the so-called Integrated Mining Technical Training (IMTT) program, a joint project with the Tanzania Chamber of Minerals and Energy and the Tanzanian government. The goal was to offer locals the skills they needed to participate in the country's burgeoning mining sector and to reduce the industry's reliance on foreign-trained expatriates.[18] Barrick used its Global Succession Planning Program (GSPP) that provided expatriates with a chance to increase their knowledge and expertise by transferring them into assignments at other Barrick sites in Tanzania, and sites in other countries where the company operated.[19] The major role of GSPP was to instill the corporate culture through the training of employees regarding various mining technology skills, and to run the company's daily practices in accordance with the corporate business interests of the company.

Mission, Vision and Values Given the questionable reputation of some global mining corporations with respect to sustainable development projects in developing societies, Barrick's core vision and values were to continue finding, acquiring, developing and producing quality reserves in a safe, profitable and socially responsible manner. Barrick claimed to promote long-term benefits to the communities in which it operated and to foster a culture of excellence and collaboration with its employees, governments and local stakeholders.

The company followed global corporate social responsibility standards as part of its larger global business strategies, using the vocabularies of business ethics, human rights and development. Among these strategies, the company placed significant emphasis on its social relationships with local communities and the right to operate in their land.[20]

Building Social Development Initiatives Barrick was committed to making a positive difference in the communities where it operated. The company focused on responsible behaviour as its duty, as well as creating opportunities to generate greater value for its shareholders, while at the same time fostering sustainable development in the communities and countries where it operated. As a global TNC, Barrick strove to earn the trust of its employees, of the communities where its subsidiary operations were based, of the host nations' governments, and of any other persons or parties with whom the company was engaged in the sustainable development of mineral resources.[21]

In 2008, the corporation established a locally based mining institution in Moshi, Kilimanjaro Region. The aim of the institute was to provide training skills and opportunities for Barrick's mining sites and other mining TNCs in the country.[22] Local individuals involved in the training program included fresh university graduates in engineering and geology, and dedicated individuals from local communities where Barrick operated. Such an initiative supported Barrick's sense of corporate responsibility towards these two groups of people

[17]www.barrick.com/CorporateResponsibility/Employees/Attracting Retaining/default.aspx, accessed April 24, 2009.

[18]www.barrick.com/Theme/Barrick/files/docs_csr/BeyondBorder 2008July.pdf#page=4, accessed September 27, 2010.

[19]www.barrick.com/CorporateResponsibility/Employees/Attracting Retaining/default.aspx, accessed September 27, 2010.

[20]www.barrick.com/CorporateResponsibility/OurCommitment/default .aspx, accessed September 27, 2010.

[21]www.barrick.com/CorporateResponsibility/default.aspx, accessed March 25, 2009.

[22]www.ippmedia.com/ipp/guardian/2008/04/11/112164.html, accessed February 13, 2009.

by providing tangible benefits to their communities in the form of employment opportunities and co-operative relationships.

Yet among community leaders and NFOs, there was clear discontent regarding the various foreign companies:

> "The government has not addressed the role of foreign companies in our communities. Some communities have been compensated by the government to clear land for the mining company, but some did not receive any money. Most communities would tell you what was given to them by the government, which is very little. They cannot build a house and send children to school and so on. They feel their livelihood is gone forever."
>
> "The mining corporation does not compensate people nor does it explain why it is operating in our communities. Of course, these companies have official binding contracts and the right to operate in our communities from the government. Local communities are in despair . . . the government is nowhere to be seen! The people are angry with the government and the mining company."
>
> "People are not happy with the government. They are aware of the extent of corruption among the government officials in the region and districts, but they cannot confront the government the way they are now confronting the mining company. They think that the company might be more sympathetic to them than the government would be with respect to offering them jobs and other opportunities."
>
> "The company has initiated several development projects in our communities [North Mara] in education, health and infrastructure. But we do not have jobs to access these better equipped services (education and health) nor essential means to support us to build community enterprises where we could apply our local skills in many activities. Though the company is doing very good projects here, we are still unhappy with the company. Our problems are long-term; they need serious engagement with us."
>
> "The company discharges water to the land, which is causing lots of environmental problems on our farms such as land erosion and polluting of the rivers. We have more mosquitoes, snakes and snails at the moment than any time in our lives because of stagnant water caused by the company's water discharge. The exploration and explosive activities conducted at night on mining sites have caused shockwaves, panic and sleepless nights among neighborhood villages, making big cracks on community farms and land."

Two community leaders (representing local stakeholders' interests) commented:

> "The other night we were all suddenly shaken by the mining blast tremor. Initially, we thought it was the so-called earthquake ("Tetemeko la Ardhi" in Swahili). What is on all the people's minds here in Bulyanhulu is, 'When will all this end?'"
>
> "We need a mutual partnership with foreign companies investing in our communities. There are so many potential benefits we can get from the company with respect to jobs and skill development; also, the company can learn a lot from us when it comes to negotiation strategies with our communities. If the company responds positively to our concerns, we will strive to protect its business interests here and it will operate in harmony in our communities. But the government needs to sit with local communities and tell them why the government has allowed the company to come to practice mining in their land and tell us what potential benefit it will bring in our communities. For the time being, the company is left to itself to address these issues with the local communities."

Amid this climate of discontent among the native Tanzanians, Barrick's mining operations were subject to some hostilities from local stakeholders. In response, the company put into place several CSR initiatives that were aimed at developing sustainable benefits within the communities and around its business operations in the core mining sites of Tulawaka, Bulyanhulu and Buzigwa. Two NFO officials in Mwanza cut to the nature of the problem:

> "The company initially attempted to collaborate with local communities and the local government to address the social and ecological issues during its initial stage of entry into the country. But it was not easy to find serious stakeholders right away. Because of the nature of the local institutions, it was also not easy to have things done quickly due to the degree of bureaucracy and the culture of corruption."
>
> "The recent protests in North Mara from local communities can be resolved only if the government, company and other social awareness groups sit together to address this situation. Shooting protestors, closing the mining site

and sending employees home without pay won't solve the problem in the long run. And the company's legal insistence of its right to operate in the communities isn't enough to convince these angry communities."

"The company is not wrong at all . . . it has followed all legal procedures and has the right to be here [in the Lake Victoria Zone], but for local communities, legal papers are NOTHING. The company finds people very unpredictable. The answer is so simple: it is all about deep understanding, integration, and building a trusting relationship."

"Mining companies are granted too many tax contracts and subsidies in order to create jobs. During this process, it is very possible for companies to avoid paying taxes that would actually benefit poor countries. There are often 'secret contracts' with corrupt government officials. The lack of institutional capacity is also a major problem; the people have not been made to see how these companies can benefit our poor societies. That's why there is still so much poverty, and that's why communities around the mining sites are angry and desperate."

Several local communities felt they were isolated when it came to the social issues that concerned them, e.g., land issues, compensation, employment, and how the presence of the company in their communities would benefit them generally. According to community leaders, few projects were initiated by the company within the various neighbourhood communities, and the ones that were enacted showed a lack of any significant sense of local ownership and influence; they did not possess the diverse forms of institutional infrastructure that fostered accountability values in communities and in the management of the company itself. As a consequence, local communities lost interest in pursuing most of the developmental projects that Barrick had initiated.

Following community tensions with Barrick between 2007 and 2009, a different strategy was developed. Implementing a locally based interaction model that promoted mutual partnership with communities seemed like the best strategic legitimacy approach. In early 2009, Barrick encountered discontent from the local communities, as well as from the local media, activists groups and lobby groups, who felt that the company had not done enough to promote sustainable and inclusive development in the communities where it operated. Barrick's new mining site at North Mara was featured several times in the media.[23] Two local NFOs commented on the dispute:

"The government needs to educate its people as to what benefits TNCs would bring to its citizens; the mining company is extracting our natural resources, causing environmental degradation and pollution, and displacing people, all with a lack of accountability, and is not doing enough for the host communities to create prosperity, jobs, local innovation and entrepreneurship initiatives."

"The source of discontent is from local communities and small-scale miners who feel neglected by the government. We strongly feel that their livelihoods have been destroyed with little or no compensation. They also feel that the government and local authorities have been giving foreign investors much attention at the expense of local people. Corruption and lack of accountability on the government side is the source of all these problems. The company is caught in the middle!"

Creating a Corporate Responsive Agenda

Barrick developed a responsive initiative to deal with the company's challenges in its international business activities abroad, including Tanzania. It established a community department in all four mining areas to oversee development initiatives. It also adopted standardized global CSR strategies as part of its larger international and localization business strategies, stating that "as a global corporation, we endorse the definition of Corporate Social Responsibility as proposed by the World Bank—Corporate Social Responsibility is the commitment of business to contribute to sustainable economic development—working with employees, their families, the local community and society at large to improve the quality of life, in ways that are both good for business and good for development."[24]

[23]Several protests by local communities against Barrick's mining activities in Tanzania had been reported. See www.protestbarrick.net/article.php?list=type&type=12, accessed February 17, 2009.

[24]www.barrick.com/CorporateResponsibility/Ethics/PoliciesStandards/default.aspx, accessed February 17, 2009.

Education in partnership with local communities

Through its newly established community department, Barrick had made a concerted attempt to identify self-employment opportunities to the communities around the Bulyanhulu gold mine. In partnership with local governments, NFOs and communities, the company had used educated locals to promote a broad array of social entrepreneurship skills in a variety of areas such as finance, accounting and marketing (see **Exhibit 2**).

The communities surrounding the mine needed a great deal of support in terms of education in order to be able to exploit the area's potential. By 2008, Barrick had committed to working closely with eight villages before expanding to another eight villages along the Bulyanhulu-Kahama road in Bulyanhulu. Seven of the eight villages were in the Bugarama ward and one was in the Mwingilo ward, but all were located in the Bulyanhulu mining area.

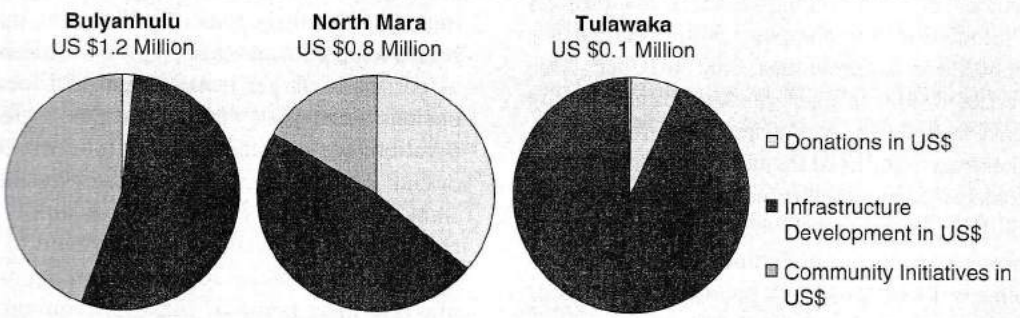
Community-based entrepreneurship

In collaboration with local community authorities, Barrick went on to assist several community groups that already possessed local skills and entrepreneurship initiatives and which had local resources to generate business activities. Other community development projects had also been started and were engineered under the same procedure of governance (**Exhibit 3**).

3. **Health**

Barrick committed itself to upgrading the Sungusungu Health Centre into what became called the Nyamongo Hospital in the Bulyanhulu area under the so-called phase I. Organized by the Evangelical Lutheran Church in the area, several NFOs had entered into an agreement with the local District Office and the Village Councils to provide health care that was affordable to the many local residents to treat diseases such as malaria, waterborne diseases, typhoid, yellow fever and other epidemiology problems. The community trust committed $30,000 towards beds and fittings and for a general upgrade to the hospital. Barrick's overall objective was to make health services available to many disadvantaged communities, and to attempt to curb the number of deaths that occurred

xhibit 2 Barrick Spending on Corporate Social Responsibility in Tanzania



Value Added in 2006 (USD)	
Donations	$ 321,000
Infrastructure Development	$ 1,110,000
Community Initiatives	$ 655,000
Local/Regional Procurement	$104,900,000

2006 Environmental, Health & Safety Performance

ote: Total amount of money in U.S. dollars spent on health & safety training and emergency response training in 2006.
urce: www.barrick.com/Theme/Barrick/files/docs_ehss/2007%20Africa%20Regional%20Rpt.pdf, accessed April 30, 2009.

Exhibit 3 Total Amount of Money Spent on Community Development Projects, 2006

Community	2006	2005	2004	2003
Donations in US$				
Bulyanhulu	20,193	14,000	410,000	485,000
North Mara	294,220	50,000	0	0
Tulawaka	6,778	7,662	5,894	n/a
Infrastructure Development in US$				
Bulyanhulu	631,222	3,570,000	4,374,000	572,000
North Mara	389,384	360,000	350,000	100,000
Tulawaka	89,020	43,697	6,250	n/a
Community Initiatives in US$				
Bulyanhulu	519,793	609,000	0	0
North Mara	135,015	0	not measured	
Tulawaka	304	0	0	n/a
Regional Purchases of Goods & Services in US$				
Bulyanhulu	65,600,000		not measured	
North Mara	37,700,000		not measured	
Tulawaka	1,600,000		not measured	

Source: www.barrick.com/Theme/Barrick/files/docs_ehss/2007%20Africa%20Regional%20Rpt.pdf, accessed April 30, 2009.

among pregnant women when they travelled from the poor communities to the district hospital.

4. **Environment**
   The Lake Victoria Zone was one of the most densely populated areas in Sub-Saharan Africa, but it was also one of the most polluted and environmentally affected places in the world. Barrick, in cooperation with local government authorities, had been working to provide opportunities to the residents of the mining areas to orient themselves with mining operations. The company was creating environmental awareness in order to create local "ambassadors" who could then go out and speak positively about the mining sites to other communities. Adequately addressing the issues of water toxins on rivers and the lake and land degradation had been the major challenge for Barrick.

Protests from so-called "secondary" stakeholders that included local communities, artisanal miners, peasant farmers and their families, and local not-for-profit organizations (NFOs) had occurred to address specific social, environmental, and land heritage and resettlement issues. All these stakeholders had widely varying claims, interests and rights. In addition, subgroups and individuals with multiple and changing roles and interests existed. They included manual mining workers who felt they had been unfairly dismissed from their jobs with little or no compensation, and felt unjustly treated by either Barrick or the Tanzanian labour court system. Local communities also had expressed anger at the level of noise caused by heavy machines during mining explorations at night and the extent of the company's impact on land in their neighborhoods. There were also individuals, mainly unemployed youths, who were engaged in intrusion, vandalism and theft at the mining sites.

Barrick had relied on the Tanzanian anti-riot police force, known as "Field Force Unit" (FFU), to quell large-scale mob criminal behaviour and demonstrations at the mining sites. Also, Barrick had relied on the Tanzanian legal system and government to protect its business activities in the region. However, the behaviour of the FFU, the weak government institutional system, and the loyalty of administrative workers to Barrick had increased anger, frustration, and resentment among communities, small-scale artisan

iners and NFOs. The FFU had been regarded by lo-
al communities as brutal and uncompromising dur-
ng confrontations. Responses by the FFU had even
ed to death,[25] long-term imprisonment of community
ampaigners' leaders, intimidation and harassment.[26]
he government had been viewed as lacking vision
nd leadership to reap the benefits of the mining ac-
ivities in the region and had been criticized for fail-
ng to protect the interests of its citizens.

Conclusion

y 2010, a variety of corporate social responsibility
CSR) initiatives were established based on ABG's
ommitment to building a sustainable relationship
ith local communities. The overall aim was to en-
ure that the company would build mutual respect,
active partnerships, and a long-term commitment with its secondary stakeholders who tended to have disparate goals, demands and opinions. Mutual respect, it was argued, was important if such relationships were to be lasting, beneficial and dynamic. In addition, the company had used its social development department in each of the mining sites to develop practical guidelines in order to facilitate the implementation of its organizational values and mission, including building long-term relationships of mutual benefit between the operations and their host communities, and to avoid costly disputes and hostilities with local stakeholders.[27] Although significant progress and successful collaborations had evolved across local communities at its mining sites, African Barrick Gold still faced serious, unique problems and increased pressure to manage conflicts and reconcile stakeholders' demands in places such as North Mara.

[25]A recent incident at a Barrick mining site in the Mara region had d the Tanzanian FFU to kill an intruder (see www.protestbarrick.net/ rticle.php?list=type&type=12, accessed April 17, 2009).

[26]For the behaviour of Tanzania's FFU in quelling demonstrations, see ww.protestbarrick.net/article.php?id=369, accessed April 17, 2009.

[27]Further CSR programs are available at www.barrick.com/CorporateResponsibility/default.aspx, accessed February 24, 2009.

Case 8-2 IKEA's Global Sourcing Challenge: Indian Rugs and Child Labor (A)

hristopher A. Bartlett, Vincent Dessain, and Anders Sjöman

n May 1995, Marianne Barner faced a tough deci-
ion. After just two years with IKEA, the world's larg-
st furniture retailer, and less than a year into her job as business area manager for carpets, she was faced with the decision of cutting off one of the company's major suppliers of Indian rugs. While such a move would disrupt supply and affect sales, she found the reasons to do so quite compelling. A German TV station had just broadcast an investigative report naming the supplier as one that used child labor in the production of rugs made for IKEA. What frustrated Barner was that, like all other IKEA suppliers, this large, well-regarded company had recently signed an addendum to its supply contract explicitly forbidding the use of child labor on pain of termination.

Even more difficult than this short-term decision was the long-term action Barner knew IKEA must

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urope Research Center Vincent Dessain, and Research Associate
nders Sjöman prepared this case. HBS cases are developed solely as
e basis for class discussion. Certain details have been disguised. Cases
e not intended to serve as endorsements, sources of primary data, or
lustrations of effective or ineffective management.

take on this issue. On one hand, she was being urged to sign up to an industry-wide response to growing concerns about the use of child labor in the Indian carpet industry. A recently formed partnership of manufacturers, importers, retailers, and Indian nongovernmental organizations (NGOs) was proposing to issue and monitor the use of "Rugmark," a label to be put on carpets certifying that they were made without child labor. Simultaneously, Barner had been conversing with people at the Swedish Save the Children organization who were urging IKEA to ensure that its response to the situation was "in the best interest of the child"—whatever that might imply. Finally, there were some who wondered if IKEA should not just leave this hornet's nest. Indian rugs accounted for a tiny part of IKEA's turnover, and to these observers, the time, cost, and reputation risk posed by continuing this product line seemed not worth the profit potential.

The Birth and Maturing of a Global Company[1]

To understand IKEA's operations, one had to understand the philosophy and beliefs of its 70-year-old founder, Ingvar Kamprad. Despite stepping down as CEO in 1986, almost a decade later, Kamprad retained the title of honorary chairman and was still very involved in the company's activities. Yet perhaps even more powerful than his ongoing presence were his strongly held values and beliefs, which long ago had been deeply embedded in IKEA's culture.

Kamprad was 17 years old when he started the mail-order company he called IKEA, a name that combined his initials with those of his family farm, Elmtaryd, and parish, Agunnaryd, located in the forests of southern Sweden. Working out of the family kitchen, he sold goods such as fountain pens, cigarette lighters, and binders he purchased from low-priced sources and then advertised in a newsletter to local shopkeepers. When Kamprad matched his competitors by adding furniture to his newsletter in 1948, the immediate success of the new line led him to give up the small items.

In 1951, to reduce product returns, he opened a display store in nearby Älmhult village to allow customers to inspect products before buying. It was an immediate success, with customers traveling seven hours from the capital Stockholm by train to visit. Based on the store's success, IKEA stopped accepting mail orders. Later Kamprad reflected, "The basis of the modern IKEA concept was created [at this time] and in principle it still applies. First and foremost, we use a catalog to tempt people to visit an exhibition, which today is our store... Then, catalog in hand, customers can see simple interiors for themselves, touch the furniture they want to buy and then write out an order."[2]

As Kamprad developed and refined his furniture retailing business model he became increasingly frustrated with the way a tightly knit cartel of furniture manufacturers controlled the Swedish industry to keep prices high. He began to view the situation not just as a business opportunity but also as an unacceptable social problem that he wanted to correct. Foreshadowing a vision for IKEA that would later be articulated as "creating a better life for the many people," he wrote: "A disproportionately large part of all resources is used to satisfy a small part of the population... IKEA's aim is to change this situation. We shall offer a wide range of home furnishing items of good design and function at prices so low that the majority of people can afford to buy them... We have great ambitions."[3]

The small newsletter soon expanded into a full catalog. The 1953 issue introduced what would become another key IKEA feature: self-assembled furniture. Instead of buying complete pieces of furniture, customers bought them in flat packages and put them together themselves at home. Soon, the "knockdown" concept was fully systemized, saving transport and storage costs. In typical fashion,

[1]This section draws on company histories detailed in Bertil Torekull, "Leading by Design—The IKEA Story" (New York: Harper Business, 1998), and on the IKEA website, available at http://www.ikea.com/ms/en_GB/about_ikea/splash.html, accessed October 5, 2005.

[2]Ingvar Kamprad, as quoted in Torekull, "Leading by Design—The IKEA Story," p. 25.

[3]Quoted in Christopher A. Bartlett and Ashish Nanda, "Ingvar Kamprad and IKEA," HBS No. 390-132 (Boston: Harvard Business School Publishing, 1990).

Kamprad turned the savings into still lower prices for his customers, gaining an even larger following among young postwar householders looking for well-designed but inexpensive furniture. Between 1953 and 1955, the company's sales doubled from SEK 3 million to SEK 6 million.[4]

Managing Suppliers: Developing Sourcing Principles As its sales took off in the late 1950s, IKEA's radically new concepts began to encounter stiff opposition from Sweden's large furniture retailers. So threatened were they that when IKEA began exhibiting at trade fairs, they colluded to stop the company from taking orders at the fairs and eventually even from showing its prices. The cartel also pressured manufacturers not to sell to IKEA, and the few that continued to do so often made their deliveries at night in unmarked vans.

Unable to meet demand with such constrained local supply, Kamprad was forced to look abroad for new sources. In 1961, he contracted with several furniture factories in Poland, a country still in the Communist eastern bloc. To assure quality output and reliable delivery, IKEA brought its know-how, taught its processes, and even provided machinery to the new suppliers, revitalizing Poland's furniture industry as it did so. Poland soon became IKEA's largest source and, to Kamprad's delight, at much lower costs—once again allowing him to reduce his prices.

Following its success in Poland, IKEA adopted a general procurement principle that it should not own its means of production but should seek to develop close ties by supporting its suppliers in a long-term relationship.[a] Beyond supply contracts and technology transfer, the relationship led IKEA to make loans to its suppliers at reasonable rates, repayable through future shipments. "Our objective is to develop long-term business partners," explained a senior purchasing manager. "We commit to doing all we can to keep them competitive—as long as they remain equally committed to us. We are in this for the long run."

Although the relationship between IKEA and its suppliers was often described as one of mutual dependency, suppliers also knew that they had to remain competitive to keep their contract. From the outset they understood that if a more cost-effective alternative appeared, IKEA would try to help them respond, but if they could not do so, it would move production.

In its constant quest to lower prices, the company developed an unusual way of identifying new sources. As a veteran IKEA manager explained: "We do not buy products from our suppliers. We buy unused production capacity." It was a philosophy that often led its purchasing managers to seek out seasonal manufacturers with spare off-season capacity. There were many classic examples of how IKEA matched products to supplier capabilities: they had sail makers make seat cushions, window factories produce table frames, and ski manufacturers build chairs in their off-season. The manager added, "We've always worried more about finding the right management at our suppliers than finding high-tech facilities. We will always help good management to develop their capacity."

Growing Retail: Expanding Abroad Building on the success of his first store, Kamprad self-financed a store in Stockholm in 1965. Recognizing a growing use of automobiles in Sweden, he bucked the practice of having a downtown showroom and opted for a suburban location with ample parking space. When customers drove home with their furniture in flat packed boxes, they assumed two of the costliest parts of traditional furniture retailing—home delivery and assembly.

In 1963, even before the Stockholm store had opened, IKEA had expanded into Oslo, Norway. A decade later, Switzerland became its first non-Scandinavian market, and in 1974 IKEA entered Germany, which soon became its largest market.

[4] Ibid.

[a] This policy was modified after a number of East European suppliers broke their contracts with IKEA after the fall of the Berlin Wall opened new markets for them. IKEA's subsequent supply chain problems and loss of substantial investments led management to develop an internal production company, Swedwood, to ensure delivery stability. However, it was decided that only a limited amount of IKEA's purchases (perhaps 10%) should be sourced from Swedwood.

Exhibit 1 IKEA Stores, Fiscal Year Ending August 1994

a. Historical Store Growth

	1954	1964	1974	1984	1994
Number of Stores	0	2	9	52	114

b. Country's First Store

	First Store (with city)	
Year	**Country**	**City**
1958	Sweden	Älmhult
1963	Norway	Oslo
1969	Denmark	Copenhagen
1973	Switzerland	Zürich
1974	Germany	Munich
1975	Australia	Artamon
1976	Canada	Vancouver
1977	Austria	Vienna
1978	Netherlands	Rotterdam
1978	Singapore	Singapore
1980	Spain	Gran Canaria
1981	Iceland	Reykjavik
1981	France	Paris
1983	Saudi Arabia	Jeddah
1984	Belgium	Brussels
1984	Kuwait	Kuwait City
1985	United States	Philadelphia
1987	United Kingdom	Manchester
1988	Hong Kong	Hong Kong
1989	Italy	Milan
1990	Hungary	Budapest
1991	Poland	Platan
1991	Czech Republic	Prague
1991	United Arab Emirates	Dubai
1992	Slovakia	Bratislava
1994	Taiwan	Taipei

Source: IKEA website, http://franchisor.ikea.com/txtfacts.html, accessed October 15, 2004.

(See **Exhibit 1** for IKEA's worldwide expansion.) At each new store the same simple Scandinavian-design products were backed up with a catalog and offbeat advertising, presenting the company as "those impossible Swedes with strange ideas." And reflecting the company's conservative values, each new entry was financed by previous successes.[b]

During this expansion, the IKEA concept evolved and became increasingly formalized. (**Exhibit 2** summarizes important events in IKEA's corporate history.) It still built large, suburban stores with knockdown furniture in flat packages the customers brought home to assemble themselves. But as the concept was refined, the company required that each store follow a predetermined design, set up to maximize customers' exposure to the product range. The concept mandated, for instance, that the living room interiors should follow immediately after the entrance. IKEA also serviced customers with features such as a playroom for children, a low-priced restaurant, and a "Sweden Shop" for groceries that had made IKEA Sweden's leading food exporter. At the same time, the range gradually expanded beyond furniture to include a full line of home furnishing products such as textiles, kitchen utensils, flooring, rugs and carpets, lamps, and plants.

The Emerging Culture and Values[5] As Kamprad's evolving business philosophy was formalized into the IKEA vision statement, "To create a better everyday life for the many people," it became the foundation of the company's strategy of selling affordable, good-quality furniture to mass-market consumers around the world. The cultural norms and values that developed to support the strategy's implementation were also, in many ways, an extension of Kamprad's personal beliefs and style. "The true IKEA spirit," he remarked, "is founded on our enthusiasm, our constant will to renew, on our cost-consciousness, on our willingness to assume responsibility and to help, on our humbleness before the task, and on the simplicity of our behavior." As well as a summary of his aspiration for the company's behavioral norms, it was also a good statement of Kamprad's own personal management style.

[b]By 2005, company lore had it that IKEA had only taken one bank loan in its corporate history—which it had paid back as soon as the cash flow allowed.

[5]Ibid.

Exhibit 2 IKEA History: Selected Events

Year	Event
1943	IKEA is founded. Ingvar Kamprad constructs the company name from his initials (**I**ngvar **K**amprad), his home farm (**E**lmtaryd), and its parish (**A**gunnaryd).
1945	The first IKEA ad appears in press, advertising mail-order products.
1948	Furniture is introduced into the IKEA product range. Products are still only advertised through ads.
1951	The first IKEA catalogue is distributed.
1955	IKEA starts to design its own furniture.
1956	Self-assembly furniture in flat packs is introduced.
1958	The first IKEA store opens in Älmhult, Sweden.
1961	Contract with Polish sources, IKEA's first non-Scandinavian suppliers. First delivery is 20,000 chairs.
1963	The first IKEA store outside Sweden opens in Norway.
1965	IKEA opens in Stockholm, introducing the self-serve concept to furniture retailing.
1965	IKEA stores add a section called the "The Cook Shop," offering quality utensils at low prices.
1973	The first IKEA store outside Scandinavia opens in Spreitenbach, Switzerland.
1974	A plastic chair developed at a supplier that usually makes buckets.
1978	The BILLY bookcase is introduced to the range, becoming an instant top seller.
1980	One of IKEA's best-sellers, the KLIPPAN sofa with removable, washable covers, is introduced.
1980	Introduction of LACK coffee table, made from a strong, light material by an interior door factory.
1985	The first IKEA Group store opens in the U.S.
1985	MOMENT sofa with frame built by a supermarket trolley factory is introduced. Wins a design prize.
1991	IKEA establishes its own industrial group, Swedwood

Source: Adapted from IKEA Facts and Figures, 2003 and 2004 editions and IKEA internal documents.

Over the years a very distinct organizational culture and management style emerged in IKEA reflecting these values. For example, the company operated very informally as evidenced by the open-plan office landscape, where even the CEO did not have a separate office, and the familiar and personal way all employees addressed one another. But that informality often masked an intensity that derived from the organization's high self-imposed standards. As one senior executive explained, "Because there is no security available behind status or closed doors, this environment actually puts pressure on people to perform."

The IKEA management process also stressed simplicity and attention to detail. "Complicated rules paralyze!" said Kamprad. The company organized "anti-bureaucrat week" every year, requiring all managers to spend time working in a store to reestablish contact with the front line and the consumer. The work pace was such that executives joked that IKEA believed in "management by running around."

Cost consciousness was another strong part of the management culture. "Waste of resources," said Kamprad, "is a mortal sin at IKEA. Expensive solutions are often signs of mediocrity, and an idea without a price tag is never acceptable." Although cost consciousness extended into all aspects of the operation, travel and entertainment expenses were particularly sensitive. "We do not set any price on time," remarked an executive, recalling that he had once phoned Kamprad to get approval to fly first class. He explained that economy class was full and that he had an urgent appointment to keep. "There is no first class in IKEA," Kamprad had replied. "Perhaps you should go by car." The executive completed the 350-mile trip by taxi.

The search for creative solutions was also highly prized with IKEA. Kamprad had written, "Only while sleeping one makes no mistakes. The fear of making mistakes is the root of bureaucracy and the enemy of all evolution." Though planning for the future was encouraged, overanalysis was not. "Exaggerated planning can be fatal," Kamprad advised his executives. "Let simplicity and common sense characterize your planning."

Exhibit 3 "A Furniture Dealer's Testament"—A Summarized Overview

In 1976, Ingvar Kamprad listed nine aspects of IKEA that he believed formed the basis of the IKEA culture together with the vision statement "To create a better everyday life for the many people." These aspects are given to all new employees through a pamphlet titled "A Furniture Dealer's Testament." The following table summarizes the major points:

Cornerstone	Summarize Description
1. The Product Range—Our Identity	IKEA sells well-designed, functional home furnishing products at prices so low that as many people as possible can afford them.
2. The IKEA Spirit—A Strong and Living Reality	IKEA is about enthusiasm, renewal, thrift, responsibility, humbleness toward the task and simplicity.
3. Profit Gives Us Resources	IKEA will achieve profit (which Kamprad describes as a "wonderful word") through the lowest prices, good quality, economical development of products, improved purchasing processes and cost savings.
4. Reaching Good Results with Small Means	"Waste is a deadly sin."
5. Simplicity is a Virtue	Complex regulations and exaggerated planning paralyze. IKEA people stay simple in style and habits as well as in their organizational approach.
6. Doing it a Different Way	IKEA is run from a small village in the woods. IKEA asks shirt factories to make seat cushions and window factories to make table frames. IKEA discounts its umbrellas when it rains. IKEA does things differently.
7. Concentration—Important to Our Success	"We can never do everything everywhere, all at the same time." At IKEA, you choose the most important thing to do and finish that before starting a new project.
8. Taking Responsibility—A Privilege	"The fear of making mistakes is the root of bureaucracy." Everyone has the right to make mistakes; in fact, everyone has obligation to make mistakes.
9. Most Things Still Remain to be Done. A Glorious Future!	IKEA is only at the beginning of what it might become. 200 stores is nothing. "We are still a small company at heart."

Source: Adapted by casewriters from IKEA's "A Furniture Dealer's Testament"; Bertil Torekull, "Leading by Design: The IKEA Story" (New York: Harper Business, 1998, p. 112); and interviews.

In 1976, Kamprad felt the need to commit to paper the values that had developed in IKEA during the previous decades. His thesis, *Testament of a Furniture Dealer,* became an important means for spreading the IKEA philosophy, particularly during its period of rapid international expansion. (Extracts of the *Testament* are given in **Exhibit 3.**) Specially trained "IKEA ambassadors" were assigned to key positions in all units to spread the company's philosophy and values by educating their subordinates and by acting as role models.

In 1986, when Kamprad stepped down, Anders Moberg, a company veteran who had once been Kamprad's personal assistant, took over as president and CEO. But Kamprad remained intimately involved as chairman, and his influence extended well beyond the ongoing daily operations: he was the self-appointed guardian of IKEA's deeply embedded culture and values.

Waking up to Environmental and Social Issues

By the mid-1990s, IKEA was the world's largest specialized furniture retailer. Sales for the IKEA Group for the financial year ending August 1994 totaled SEK 35 billion (about $4.5 billion). In the previous year, more than 116 million people had visited one of the 98 IKEA stores in 17 countries, most of them drawn there by the company's product catalog, which was printed yearly in 72 million

copies in 34 languages. The privately held company did not report profit levels, but one estimate put its net margin at 8.4% in 1994, yielding a net profit of SEK 2.9 billion (about $375 million).[6]

After decades of seeking new sources, in the mid-1990s IKEA worked with almost 2,300 suppliers in 70 countries, sourcing a range of around 11,200 products. Its relationship with its suppliers was dominated by commercial issues, and its 24 trading service offices in 19 countries primarily monitored production, tested new product ideas, negotiated prices, and checked quality. (See **Exhibit 4** for selected IKEA figures in 1994.) That relationship began to change during the 1980s, however, when environmental problems emerged with some of its products. And it was even more severely challenged in the mid-1990s when accusations of IKEA suppliers using child labor surfaced.

Exhibit 4 IKEA in Figures, 1993/1994 (fiscal year ending August 31, 1994)

a. Sales

Country/Region	SEK Billion	Percentage
Germany	10.4	29.70%
Sweden	3.9	11.20%
Austria, France, Italy, Switzerland	7.7	21.90%
Belgium, Netherlands, United Kingdom, Norway	7.3	20.80%
North America (U.S.A and Canada)	4.9	13.90%
Czech Republic, Hungary, Poland, Slovakia	0.5	1.50%
Australia	0.4	1.00%
	35.0	

b. Purchasing

Country/Region	Percentage
Nordic Countries	33.4%
East and Central Europe	14.3%
Rest of Europe	29.6%
Rest of the World	22.7%

Source: IKEA Facts and Figures, 1994.

[6]Estimation in Bo Pettersson, "Han släpper aldrig taget," *Veckans Affärer*, March 1, 2004, pp. 30–48.

The Environmental Wake-Up: Formaldehyde

In the early 1980s, Danish authorities passed regulations to define limits for formaldehyde emissions permissible in building products. The chemical compound was used as binding glue in materials such as plywood and particleboard and often seeped out as gas. At concentrations above 0.1 mg/kg in air, it could cause watery eyes, headaches, a burning sensation in the throat, and difficulty breathing. With IKEA's profile as a leading local furniture retailer using particleboard in many of its products, it became a prime target for regulators wanting to publicize the new standards. So when tests showed that some IKEA products emitted more formaldehyde than was allowed by legislation, the case was widely publicized and the company was fined. More significantly—and the real lesson for IKEA—was that due to the publicity, its sales dropped 20% in Denmark.

In response to this situation, the company quickly established stringent requirements regarding formaldehyde emissions but soon found that suppliers were failing to meet its standards. The problem was that most of its suppliers bought from sub-suppliers, who in turn bought the binding materials from glue manufacturers. Eventually, IKEA decided it would have to work directly with the glue-producing chemical companies and, with the collaboration of companies such as ICI and BASF, soon found ways to reduce the formaldehyde offgassing in its products.[7]

A decade later, however, the formaldehyde problem returned. In 1992, an investigative team from a large German newspaper and TV company found that IKEA's best-selling bookcase series, Billy, had emissions higher than German legislation allowed.

[7]Based on case study by The Natural Step, "Organizational Case Summary: IKEA," available at http://www.naturalstep.org/learn/docs/cs/case_ikea.pdf, accessed October 5, 2005.

This time, however, the source of the problem was not the glue but the lacquer on the bookshelves. In the wake of headlines describing "deadly poisoned bookshelves," IKEA immediately stopped both the production and sales of Billy bookcases worldwide and corrected the problem before resuming distribution. Not counting the cost of lost sales and production or the damage to goodwill, the Billy incident was estimated to have cost IKEA $6 million to $7 million.[8]

These events prompted IKEA to address broader environmental concerns more directly. Since wood was the principal material in about half of all IKEA products, forestry became a natural starting point. Following discussions with both Greenpeace and World Wide Fund for Nature (WWF, formerly World Wildlife Fund) and using standards set by the Forest Stewardship Council, IKEA established a forestry policy stating that IKEA would not accept any timber, veneer, plywood, or layer-glued wood from intact natural forests or from forests with a high conservation value. This meant that IKEA had to be willing to take on the task of tracing all wood used in IKEA products back to its source.[9] To monitor compliance, the company appointed forest managers to carry out random checks of wood suppliers and run projects on responsible forestry around the world.

In addition to forestry, IKEA identified four other areas where environmental criteria were to be applied to its business operations: adapting the product range; working with suppliers; transport and distribution; and ensuring environmentally conscious stores. For instance, in 1992, the company began using chlorine-free recycled paper in its catalogs; it redesigned the best-selling OGLA chair—originally manufactured from beech—so it could be made using waste material from yogurt cup production; and it redefined its packaging principles to eliminate any use of PVC. The company also maintained its partnership with WWF, resulting in numerous projects on global conservation, and funded a global forest watch program to map intact natural forests worldwide. In addition, it engaged in an ongoing dialogue with Greenpeace on forestry.[10]

The Social Wake-Up: Child Labor In 1994, as IKEA was still working to resolve the formaldehyde problems, a Swedish television documentary showed children in Pakistan working at weaving looms. Among the several Swedish companies mentioned in the film as importers of carpets from Pakistan, IKEA was the only high-profile name on the list. Just two months into her job as business area manager for carpets, Marianne Barner recalled the shockwaves that the TV program sent through the company:

> The use of child labor was not a high-profile public issue at the time. In fact, the U.N. Convention on the Rights of the Child had only been published in December 1989. So, media attention like this TV program had an important role to play in raising awareness on a topic not well known and understood—including at IKEA... We were caught completely unaware. It was not something we had been paying attention to. For example, I had spent a couple of months in India learning about trading but got no exposure to child labor. Our buyers met suppliers in their city offices and rarely got out to where production took place... Our immediate response to the program was to apologize for our ignorance and acknowledge that we were not in full control of this problem. But we also committed to do something about it.

As part of its response, IKEA sent a legal team to Geneva to seek input and advice from the International Labor Organization (ILO) on how to deal with the problem. They learned that Convention 138, adopted by the ILO in 1973 and ratified by 120 countries, committed ratifying countries to working for the abolition of labor by children under 15 or the age of compulsory schooling in that country. India, Pakistan, and Nepal were not signatories to the convention.[11] Following these discussions with the

[8] Ibid.

[9] "IKEA—Social and Environmental Responsibility Report 2004," p. 33, available at http://www.ikea-group.ikea.com/corporate/PDF/IKEA_SaER.pdf, accessed October 5, 2005.

[10] Ibid., pp. 19–20.

[11] Ratification statistics available on ILO website, page titled "Convention No. C138 was ratified by 142 countries," available at http://www.ilo.org/ilolex/cgi-lex/ratifce.pl?C138, accessed December 4, 2005.

ILO, IKEA added a clause to all supply contracts—a "black-and-white" clause, as Barner put it—stating simply that if the supplier employed children under legal working age, the contract would be cancelled.

To take the load off field trading managers and to provide some independence to the monitoring process, the company appointed a third-party agent to monitor child labor practices at its suppliers in India and Pakistan. Because this type of external monitoring was very unusual, IKEA had some difficulty locating a reputable and competent company to perform the task. Finally, they appointed a well-known Scandinavian company with extensive experience in providing external monitoring of companies' quality assurance programs and gave them the mandate not only to investigate complaints but also to undertake random audits of child labor practices at suppliers' factories.

Early Lessons: A Deeply Embedded Problem

With India being the biggest purchasing source for carpets and rugs, Barner contacted Swedish Save the Children, UNICEF, and the ILO to expand her understanding and to get advice about the issue of child labor, especially in South Asia. She soon found that hard data was often elusive. While estimates of child labor in India varied from the government's 1991 census figure of 11.3 million children under 15 working[12] to Human Rights Watch's estimate of between 60 million and 115 million child laborers,[13] it was clear that a very large number of Indian children as young as five years old worked in agriculture, mining, quarrying, and manufacturing, as well as acting as household servants, street vendors, or beggars. Of this total, an estimated 200,000 were employed in the carpet industry, working on looms in large factories, for small subcontractors, and in homes where whole families worked on looms to earn extra income.[14]

Children could be bonded—essentially placed in servitude—in order to pay off debts incurred by their parents, typically in the range of 1,000 to 10,000 rupees ($30 to $300). But due to the astronomical interest rates and the very low wages offered to children, it could take years to pay off such loans. Indeed, some indentured child laborers eventually passed on the debt to their own children. The Indian government stated that it was committed to the abolition of bonded labor, which had been illegal since the Children (Pledging of Labour) Act passed under British rule in 1933. The practice continued to be widespread, however, and to reinforce the earlier law, the government passed the Bonded Labour System (Abolition) Act in 1976.[15]

But the government took a less absolute stand on unbonded child labor, which it characterized as "a socioeconomic phenomenon arising out of poverty and the lack of development." The Child Labour (Prohibition and Regulation) Act of 1986 prohibited the use of child labor (applying to those under 14) in certain defined "hazardous industries" and regulated children's hours and working conditions in others. But the government felt that the majority of child labor involved "children working alongside and under the supervision of their parents" in agriculture, cottage industries, and service roles. Indeed, the law specifically permitted children to work in craft industries "in order not to outlaw the passage of specialized handicraft skills from generation to generation."[16] Critics charged that even with these laws on the books, exploitive child labor—including bonded labor—was widespread because laws were poorly enforced and prosecution rarely severe.[17]

Action Required: New Issues, New Options

In the fall of 1994, after managing the initial response to the crisis, Barner and her direct manager traveled to India, Nepal, and Pakistan to learn

[12]Indian Government Policy Statements, "Child Labor and India," available at http://www.indianembassy.org/policy/Child_Labor/childlabor_2000.htm, accessed October 1, 2005.

[13]Human Rights Watch figures, available at http://www.hrw.org/reports/1996/India3.htm, accessed October 1, 2005.

[14]Country Reports in Human Rights, U.S. State Department, February 2000, available at http://www.state.gov/g/drl/rls/hrrpt/2000/, accessed October 1, 2005.

[15]Indian Government Policy Statements, "Child Labor and India," available at http://www.indianembassy.org/policy/Child_Labor/childlabor_2000.htm, accessed October 1, 2005.

[16]Ibid.

[17]Human Rights Watch data, available at http://www.hrw.org/reports/1996/India3.htm, accessed October 1, 2005.

more. Barner recalled the trip: "We felt the need to educate ourselves, so we met with our suppliers. But we also met with unions, politicians, activists, NGOs, U.N. organizations, and carpet export organizations. We even went out on unannounced carpet factory raids with local NGOs; we saw child labor, and we were thrown out of some places."

On the trip, Barner also learned of the formation of the Rugmark Foundation, a recently initiated industry response to the child labor problem in the Indian carpet industry. Triggered by a consumer awareness program started by human rights organizations, consumer activists, and trade unions in Germany in the early 1990s, the Indo-German Export Promotion Council had joined up with key Indian carpet manufacturers and exporters and some Indian NGOs to develop a label certifying that the hand-knotted carpets to which it was attached were made without the use of child labor. To implement this idea, the Rugmark Foundation was organized to supervise the use of the label. It expected to begin exporting rugs carrying a unique identifying number in early 1995. As a major purchaser of Indian rugs, IKEA was invited to sign up with Rugmark as a way of dealing with the ongoing potential for child labor problems on products sourced from India.

On her return to Sweden, Barner again met frequently with the Swedish Save the Children's expert on child labor. "The people there had a very forward-looking view on the issue and taught us a lot," said Barner. "Above all, they emphasized the need to ensure you always do what is in the best interests of the child." This was the principle set at the heart of the U.N. Convention on the Rights of the Child (1989), a document with which Barner was now quite familiar. (See **Exhibit 5** for Article 32 from the U.N. Convention on the Rights of the Child.)

The more Barner learned, the more complex the situation became. As a business area manager with full profit-and-loss responsibility for carpets, she knew she had to protect not only her business but also the IKEA brand and image. Yet she viewed her responsibility as broader than this: She felt the company should do something that would make a difference in the lives of the children she had seen. It was a view that was not universally held within IKEA, where many were concerned that a very proactive stand could put the business at a significant cost disadvantage to its competitors.

A New Crisis Then, in the spring of 1995, a year after IKEA began to address this issue, a well-known German documentary maker notified the company that a film he had made was about to be broadcast on German television showing children working at looms at Rangan Exports, one of IKEA's major suppliers. While refusing to let the company preview the video, the filmmaker produced still shots taken directly from the video. The producer then invited IKEA to send someone to take part in a live discussion during the airing of the

Exhibit 5 The U.N. Convention on the Rights of the Child: Article 32

1. States Parties recognize the right of the child to be protected from economic exploitation and from performing any work that is likely to be hazardous or to interfere with the child's education, or to be harmful to the child's health or physical, mental, spiritual, moral, or social development.
2. States Parties shall take legislative, administrative, social, and educational measures to ensure the implementation of the present article. To this end, and having regard to the relevant provisions of other international instruments, States Parties shall in particular:
   a. Provide for a minimum age for admission to employment
   b. Provide for appropriate regulation of hours and conditions of employment
   c. Provide for appropriate or other sanctions to ensure the effective enforcement of the present article.

Source: Excerpt from "Convention on the Rights of the Child," from the website of the Office of the United Nations High Commissioner for Human Rights, available at http://www.unhchr.ch/html/menu3/b/k2crc.htm, accessed October 2005.

program. Said Barner, "Compared to the Swedish program, which documented the use of child labor in Pakistan as a serious report about an important issue without targeting any single company, it was immediately clear that this German-produced program planned to take a confrontational and aggressive approach aimed directly at IKEA and one of its suppliers."

For Barner, the first question was whether to recommend that IKEA participate in the program or decline the invitation. Beyond the immediate public relations issue, she also had to decide how to deal with Rangan Exports' apparent violation of the contractual commitment it had made not to use child labor. And finally, this crisis raised the issue of whether the overall approach IKEA had been taking to the issue of child labor was appropriate. Should the company continue to try to deal with the issue through its own relationships with its suppliers? Should it step back and allow Rugmark to monitor the use of child labor on its behalf? Or should it recognize that the problem was too deeply embedded in the culture of these countries for it to have any real impact and simply withdraw?

Case 8-3 Genzyme's CSR Dilemma: How to Play Its HAND

Christopher A. Bartlett, Tarun Khanna, and Prithwiraj Choudhury

On a cold but sunny day in January 2009, as sunlight reflected through the adjustable mirror panels of Genzyme's landmark "green" headquarters, Jim Geraghty was reflecting on discussions in a just-concluded phone call. Geraghty, senior vice president at Genzyme, had been instrumental in creating the Humanitarian Assistance for Neglected Diseases (HAND) program. Launched in April 2006, HAND was a cornerstone of Genzyme's corporate social responsibility (CSR) initiatives, and its steering committee had just completed a conference call meeting to decide its future priorities.

Two special invitees on the call—Sandeep Sahney, managing director of Genzyme India, and Rogerio Vivaldi, senior vice president and head of the Latin American operations—had been asked to provide information to help the committee decide which HAND initiative to support going forward. Sahney was championing the malaria research project with the Indian partner ICGEB, while Vivaldi was making a strong case for extending the Brazilian research program on Chagas disease with local partner Fiocruz. There were other options on the table, including the idea of starting a HAND tuberculosis project.

When Sahney and Vivaldi left the call, Geraghty focused the committee members on the recommendations they would take to Henri Termeer, Genzyme CEO. Which research initiative would have maximum impact? What was the right future model for partnering? And what were the funding and resource needs for scaling up the program?

Professors Christopher A. Bartlett and Tarun Khanna and Doctoral Candidate Prithwiraj Choudhury prepared this case. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

Laying the Corporate Foundation Stones[a]

From modest beginnings in 1981 as a supplier of enzymes, fine chemicals, and reagents to research labs and pharmaceutical companies, Genzyme had grown to become a leader in biotechnology with revenues of almost $4 billion in 2007 (see **Exhibit 1** for key financial indicators and **Exhibit 2** for stock price movement). It had done so by identifying its patients' needs, targeting a focused technology capability, and developing a set of values that clearly defined its role as a corporation within society.

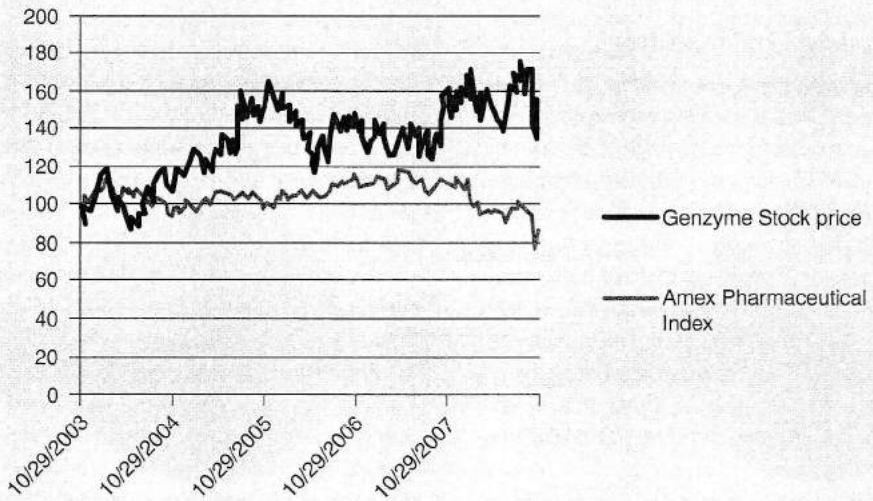
[a]This section is adapted from Christopher A. Bartlett and Andrew McLean, "Genzyme's Gaucher Initiative: Global Risk and Responsibility," HBS No. 303-048 (Boston: Harvard Business School Publishing, 2002).

Exhibit 1 Key Financial Indicators at Genzyme

(Dollars in thousands, except for share data)	2003	2004	2005	2006	2007	2008
Revenues	1,574,817	2,201,145	2,734,842	3,187,013	3,813,519	4,605,039
Gross margin	1,143,123	1,599,997	2,082,030	2,433,856	2,856,774	3,414,436
Operating income (loss)	174,012	252,913	600,862	(190,509)	653,865	581,479
Net income (loss)	94,283	86,527	441,489	(16,797)	480,193	421,081
Earnings per share (diluted)	$0.42	$0.37	$1.65	$(0.06)	$1.74	$1.50
Cash and investments	1,227,460	1,079,454	1,089,102	1,285,604	1,460,394	973,691
Working capital	930,951	1,009,231	1,114,976	1,338,062	1,137,904	1,601,852
Total assets	5,004,528	6,069,421	6,878,865	7,191,188	8,314,375	8,671,276
Long-term obligations	1,676,091	1,064,867	1,178,975	879,038	217,511	451,000
Stockholder's equity	2,936,412	4,380,156	5,149,867	5,660,711	6,612,937	7,305,993

Source: Genzyme website, http://www.genzyme.com/corp/investors/2008_annualreport.pdf, accessed on 08/12/2009.

Exhibit 2 Genzyme's Stock Price Movement Benchmarked Against Pharmaceutical Index (2003–2008)



Source: Genzyme stock price data from Thomson Datastream, accessed on March 31, 2009; Amex pharmaceutical index data, http://www.amex.com/othProd/prodInf/OpPiChartDet.jsp?monthVal=12&Product_Symbol=DRG, accessed on March 31, 2009.

From its earliest days, Genzyme had focused on orphaned diseases (those with too small a population of sufferers to attract drug development attention), a strategy reflected in its portfolio of drugs (see **Exhibit 3** for its major products and **Exhibit 4** for a portfolio of products for orphan and neglected diseases).

Nurturing an Early Breakthrough Two years after creating the company, founder Henry Blair recognized that he needed help in managing his fast-growing start-up. In 1983, he hired Henri Termeer, a 36-year-old division president at medical products giant Baxter International, bringing him in as Genzyme's president. Recognizing the

Exhibit 3 Genzyme's Product Portfolio

Major Current products ranked by sales*

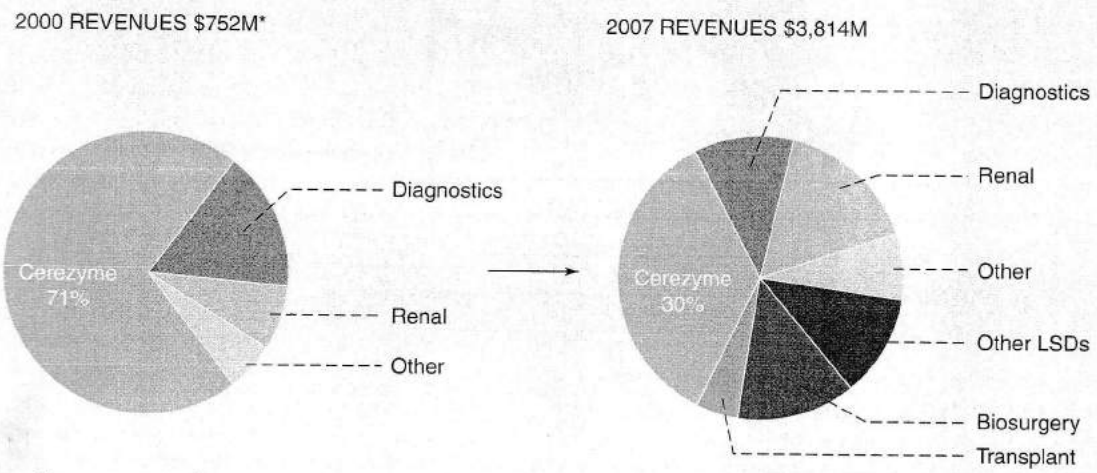
Product Name	Disease/Condition	Is the Medication for an "Orphan Disease"?	Revenue in 2007
Cerezyme®	Gaucher disease	Yes	$1.13 billion
Renagel®	End-stage renal disease	No	$603 million
Fabrazyme®	Fabry disease	Yes	$424 million
Synvisc®	Osteoarthritis of the knee	No	$242 million

*List incomplete

Products in the Pipeline

Product Name	Disease/Condition
Mozobil™ (plerixafor)	Stem cell transplant
Alemtuzumab (Campath®)	Multiple sclerosis
Clolar® (clofarabine)	Adult acute myeloid leukemia
Mipomersen	High-risk hypercholesterolemia

Revenue Breakdown by Product Area



Source: Genzyme company documents.

Exhibit 4 Genzyme's Existing Product Portfolio for Orphan or Neglected Diseases

Neglected/Orphan Disease	Treatment	First Approved	Patients on Therapy as of January 1, 2008	Approx. Annual Treatment Cost Per Patient ($)	Percentage of Patients Who Get Free Treatment
Type 1 Gaucher disease	Cerezyme	1991 (first-generation product Ceredase)	5,200	$200,000	10% (through Project Hope)
Fabry disease	Fabrazyme	2001	2,200	$200,000	10%
MPS I	Aldurazyme (with BioMarin Pharmaceutical)	2003	600	$200,000	10%
Pompe disease	Myozyme	2006	900	$300,000	10%

Note: As the last column of this table indicates, Genzyme sells most of these products commercially. The HAND program is completely separate to these initiatives.
Source: Interviews with Genzyme executives.

importance of R&D to build a diversified pipeline of products, Termeer initiated a series of weekend technology strategy discussions involving top management, MIT and Harvard faculty, key investors, and a few outside advisers.

One potential opportunity that caught Termeer's eye was an ongoing trial being conducted by Dr. Roscoe Brady of the National Institutes of Health (NIH). Brady was conducting research on Gaucher (pronounced GO-shay) disease, and Genzyme had received a contract to supply an enzyme called GCR. Gaucher is an extremely rare and deadly condition caused by the body's inability to manufacture the GCR enzyme. It affected fewer than six of every one million people, of whom only a quarter were thought to be ill enough to require treatment.

Early trials of Brady's treatment were disappointing. Only one of seven patients in the trial showed any response to the therapy, but the intriguing fact was that in this particular case, the symptoms were dramatically reversed. Most within Genzyme were pessimistic about the therapy. In addition to questions about the therapy's efficacy, there were two other major concerns—whether it was safe (the enzyme was extracted from human placentas and there were risks of HIV and hepatitis C transmission), and whether the investment would earn a significant return.

But Termeer wasn't ready to give up. After learning that the one patient in dramatic recovery was a four-year-old boy from the Washington, D.C., area, he visited the boy's family regularly over the next few months and was impressed with the treatment's effectiveness. Eventually, despite the many concerns being expressed, Termeer decided to proceed with the development.

In 1985, soon after Termeer was appointed CEO and had taken the company public, Genzyme made an orphan drug application for the Ceredase enzyme under the Orphan Drug Act.[b] The company estimated that *if* further trials were successful and *if* the orphan drug status was awarded, it could serve around 2,000 patients worldwide, with projected annual sales of $100 million. Finally, in 1991, the U.S. Food and Drug Administration approved Ceredase for marketing in the United States.

[b]Under the Orphan Drug Act of January 1983, companies doing research on rare diseases affecting fewer than 200,000 people in the United States were awarded tax breaks and marketing exclusivity on that drug for seven years postapproval.

Weathering Political and Regulatory Pressures Ceredase was launched into a difficult political environment for pharmaceutical and biotech companies. President Clinton's emphasis on health-care reform turned the spotlight on high-priced therapies, and with Gaucher medication costing $50,000 to $100,000 a year per patient, Genzyme came under scrutiny. Termeer's response was to go to Washington and meet with members of Congress and the regulatory authorities. As he recalled later, "I invited them to visit our operations and offered to open our books so they could see what it cost to develop and produce the product. Our approach was to be completely open and transparent. We were proud of what we had done and had nothing to hide."

After showing his visitors the facilities and giving the Congressional Office of Technology Assessment (OTA) open access to Genzyme's books, Termeer explained the company's philosophy: "Since the beginning, I have told this organization that our first responsibility is to treat patients with the disease, not to maximize financial returns." With this objective, even before Ceredase was approved, Genzyme created the Ceredase Assistance Program (CAP) to provide free medication to the patients in most need. After a detailed examination, in October 1992, the OTA concluded that while the Orphan Drug Act protection did reduce risks, Genzyme had invested significantly in R&D and production facilities and the company's pretax margin on the drug was within industry norms.

Building a Global Organization As the Ceredase trials continued, Genzyme began building a new $180 million manufacturing facility. With such a small population of Gaucher sufferers, Termeer realized the company needed to expand into global markets in order to generate volume for the plant. As Genzyme expanded abroad, the CEO insisted that the marketing focus be on the core corporate value of "putting patients first."

Assembling a go-to-market team for an extremely expensive therapy for a rare and seldom diagnosed disease was a daunting task. Salespeople would have to educate doctors, pharmacies, and hospitals about the disease in a variety of different health-care environments. Management quickly concluded that the key was to recruit "passionate practical dreamers" as they called them. Termeer tapped his Baxter alumni network to hire senior people to lead Genzyme's entry into Europe, the Middle East, Asia, Canada, and Latin America into the new millennium.

Paralleling its domestic commitment to provide treatment to all Gaucher sufferers, in 1998 the company launched a global version of CAP called the Gaucher Initiative with the objective of delivering treatment to those in less developed countries. To help deliver treatment to these countries, Genzyme teamed up with Project HOPE (Health Opportunities for People Everywhere) as its global nongovernmental organization (NGO) partner, deciding to focus first on untreated sufferers in Egypt and China.

In implementing the Gaucher Initiative, the embedded corporate value of putting patients first was translated into a "two-price policy" for the drug—full price, or free for patients who could not afford it. An independent six-member medical review board was created to review and approve economically challenged patients. Project HOPE would handle the drug's delivery to developing countries, while Genzyme agreed to provide free drugs, pay for the program manager and the secretariat, and provide training, travel, and office peripherals for local treatment centers. In 1998, the Gaucher Initiative took on 60 patients worldwide. Three years later, this number was 140.

Shaping a New Industry Image While Genzyme was developing the Gaucher Initiative, Termeer was becoming increasingly concerned about the failure of the pharmaceutical industry to create sustainable goodwill with NGOs, government agencies, and the public at large, especially in emerging markets. He was astounded in 1999, when 28 big pharmaceutical companies sued the South African government and President Mandela personally for passing a law allowing the import of affordable generic versions of patented AIDS drugs to treat millions of sufferers for the first time. While the companies argued that the law treated them unfairly, NGOs and AIDS

activists argued that commercial interests could not override the human rights of people who were simply trying to stay alive."[1]

Termeer was determined to take a radically different approach at Genzyme. Given the company's patient-focused culture and its sense of corporate social responsibility, he saw an opportunity to seize the initiative by responding to requests from governments in developing countries to invest locally in helping them respond to neglected diseases—diseases that were not attracting drug development attention despite the large number of sufferers. The company was accustomed to working with government health-care agencies worldwide to achieve its goal of obtaining treatment for rare orphan diseases like Gaucher. Now he felt it might be able to leverage those relationships and offer help in finding solutions for more common neglected diseases.

Beyond Orphan Diseases to Neglected Diseases

In the spring of 2005, as Termeer began testing this idea with his staff, Peter Wirth, Genzyme's corporate counsel, suggested that he talk to his wife Dyann Wirth, chair of the Department of Immunology and Infectious Diseases at the Harvard School of Public Health. It was the first step in an exploration of neglected diseases where Genzyme's capabilities could be brought to bear.

Malaria In her conversation with Termeer, Dyann Wirth described the work she was doing on malaria in collaboration with the Broad Institute, a joint venture of the Massachusetts Institute of Technology (MIT), Harvard, and the Whitehead Institute. Following that discussion, Termeer asked Geraghty to schedule a follow-up meeting with Wirth and Eric Lander, MIT professor and director of the Broad Institute. At that meeting, Termeer and Geraghty learned that an estimated 500 million people were affected by malaria, a number that was expected to increase to 1 billion by 2025.

They also learned that while malaria caused more than 1 million deaths every year, only 0.3% of global health R&D was spent on its drug research. Geraghty explained the potential for Genzyme to contribute: "We had complementary skills to academics like Wirth and Lander who were experts in basic research focused on drug discovery. Genzyme had skills in translating projects from the research stage to a clinical case. Between us, we could make a real contribution."

Chagas Disease/Sleeping Sickness Another candidate for the emerging idea of developing cures for neglected diseases was brought to light by conversations Geraghty had with a Brazilian researcher he had met at a malaria conference. They had discussed a parasitic illness called Chagas disease, or American trypanosomiasis. That conversation triggered a recollection. In March 2004, Genzyme had bought Ilex Oncology Inc., a biotechnology company focused on the treatment of bladder cancer, solid tumors, and other forms of cancer. But as part of its oncology repertoire, Ilex had on its shelves a drug called eflornithine, which had been shown to have an unexpected yet positive effect on African trypanosomiasis, or sleeping sickness.

Sleeping sickness is a parasitic disease in people and animals that is transmitted by the tsetse fly. It is especially prevalent in Sub-Saharan Africa and affects around 50,000 to 70,000 people a year. After it was nearly eradicated in the twentieth century, relaxation in control methods led to a resurgence. Although treatments existed, they were highly toxic, and resistance was spreading fast. Early research indicated that eflornithine was very effective in treating Stage II sleeping sickness, with the only problem being that its requirement for intravenous treatment four times per day was too difficult to be practical in remote sections of Africa.

Chagas disease, named after the Brazilian physician Carlos Chagas who first described it in 1909, is caused by a related parasite and is widespread in Latin America. A disease without a vaccine, it is

[1] March 5, 2001, press article, "South Africa battles for cheap AIDS drugs," http://www.thepost.ohiou.edu/archives3/mar01/030501/brief4.html, accessed August 15, 2009.

transmitted to humans and other mammals mostly by blood-sucking assassin bugs.

Tuberculosis A third major neglected disease candidate presented itself in 2006 in discussions that followed an approach from the Global Alliance for TB Drug Development, a New York–based nonprofit dedicated to the discovery and development of faster-acting and more affordable tuberculosis (TB) treatments. Through that contact, Geraghty began to learn about TB, and felt Genzyme might be able to help.

A widespread and highly infectious disease, TB has a footprint across large parts of Africa, China, South Asia, and elsewhere and is responsible for among the highest deaths of all neglected diseases (see **Exhibit 5** for a comparison of neglected

Exhibit 5 Comparison of Key Neglected Diseases

	Malaria	Chagas	Sleeping Sickness	Tuberculosis
Region affected	In the equatorial areas of the Americas, Asia, and Africa. However, 85%–90% of malaria fatalities occur in Sub-Saharan Africa	Mexico, Central and South America	36 countries in Sub-Saharan Africa	Throughout the developing world; 22 "high-burden" countries include India, Pakistan, China, Indonesia, Nigeria, and Bangladesh
Total people affected every year	250 million cases every year	16–18 million	~500,000	~25 million
Total number of people for whom the disease poses a threat	3.3 billion	100 million	60 million	>4 billion
Number of deaths every year	1 million	50,000	>40,000	1.5–2 million
Spread	Caused by protozoan parasites spread by female Anopheles mosquitoes. Two strains: *falciparum* (Africa, India, elsewhere) and *vivax* (mostly in India)	Transmission is mainly through triatomine bugs, which hide during the day, but emerge at night to bite and infect sleeping victims	Infected tsetse fly injects metacyclic trypomastigotes parasite into the skin tissue while biting the mammalian host.	Spread through the air, when people who have the disease cough, sneeze, or spit.

Source: Data collected from interviews with Genzyme executives and from the following websites:
http://www.who.int/mediacentre/factsheets/fs094/ en/index.html, accessed on March 31, 2009.
http://www.who.int/features/factfiles/malaria/en/index.html, accessed on August 12, 2009.
http://www.who.int/ neglected_diseases/diseases/chagas/en/index.html, accessed on March 31, 2009.
http://www.who.int/ mediacentre/factsheets/fs259/en/, accessed on March 31, 2009.
http://www.sleepingsickness.org/Background.html, accessed on August 15, 2009.

diseases). It infects one-third of the world's population and is spread when those with the disease cough or spit, causing new infections at the rate of one per second. Although most of these cases are latent, about 1 in 10 became full-blown TB. If left untreated, the disease will kill more than half its victims. In 2004, there were almost 15 million active chronic cases of TB, 9 million new cases, and 1.6 million deaths in the year, almost all in developing countries.

Despite these disturbing statistics, TB was still being treated by a combination of four drugs developed in the 1960s. Pharmaceutical companies had done little R&D in recent decades due to the disease's concentration in developing countries, which could not afford expensive health care. Drugs were available to less than half of the most infectious cases, and even when they were provided, treatment took six months. The need for constant drug administration and monitoring was beyond the capability of most developing countries, so treatment was often abandoned before it was completed. This had fueled the rise of XDR-TB, a new and highly drug-resistant form of the disease.

Opening a Helping HAND: Forming the Program

With these exploratory discussions in motion, Termeer decided to outline his vision for how Genzyme could contribute to the plight of those suffering from such widespread, neglected diseases. The opening of Genzyme's U.K. R&D center in September 2005 provided him with an opportunity. In his speech dedicating the center, he said: "In the new millennium the challenge will be to find dramatic new ways to serve people suffering from neglected diseases around the world, especially the billions ignored by traditional pharma companies in emerging markets."

Caren Arnstein, vice president of corporate communications at Genzyme, recalled listening to the speech: "Henri's speech caught us all a bit by surprise. He was way ahead of us. But what he said was not only uplifting and inspirational; it also showed his deep personal commitment to act. It was as if he was trying to raise the game for all of us. That's how the HAND initiative was born."

Setting Goals and Guidelines After many internal conversations, in February 2006, Termeer formed a steering committee of Geraghty; Arnstein; Ted Sybertz, senior vice president of scientific affairs; and Jeff Klinger, vice president of infectious diseases. In April, the committee formally launched the Humanitarian Assistance for Neglected Diseases (HAND) program. Termeer articulated the thinking behind the program's creation: "Genzyme's customers are mostly government agencies that buy expensive medication for rare diseases like Gaucher. In the long term, these organizations are not comfortable engaging on the basis of cold commerce alone, and neither are we. The HAND initiative is Genzyme's way of giving back."

Technically, any entry on the World Health Organization (WHO) list of Neglected Tropical Diseases could qualify for the HAND program. However, the steering committee proposed some simple criteria to guide its choices going ahead (see **Exhibit 6** for minutes from a committee meeting). Projects had to be related to an "important unmet medical need" where Genzyme had "technological capability," "credible partners," and the "ability to afford the next phase of development, ideally with long-term funding."

Geraghty explained the rationale behind the company's strong preference for engaging others in partnerships: "Even if we increased our own investment by two- or threefold to $6 million to $10 million, we would have very little incremental impact. We not only need to leverage our own capabilities, we want to influence others and become an industry role model." He also explained that HAND's objectives were explicitly "beyond narrow commercial interests" and emphasized that Genzyme "would not seek profit from these programs." Indeed, the company committed to make available all intellectual property generated from the HAND program so that partners and governments around the world could benefit.

Building Capability HAND was going to require significant resources, and the challenge for Genzyme was to provide it with the technology

Exhibit 6 HAND Steering Committee Meeting Minutes, February 2006 (selected text)

Mission of HAND Program

Neglected diseases such as malaria are enormous public health problems in many areas, killing more than a million people each year, mostly children. There is an urgent need to discover new and effective drugs. Industry has a unique contribution to make by applying drug discovery and preclinical development capabilities to create new solutions. In partnership with others, Genzyme seeks to be a catalyst in advancing the development of novel therapies for neglected diseases.

Objectives

- Partner with others in conducting work that can advance the development of novel therapies for important neglected diseases
- Create a vehicle for Genzyme's global health initiative that has a structure and process for screening, selecting and accounting for scientific projects
- Establish a process for making IP available for use in the field

Project Selection Criteria

- Important unmet medical need, ideally recognized as public health priority
- Medically effective product profile, ideally very inexpensive
- Evidence-based scientific rationale, ideally with a well-defined pathway and development plan
- Ability to make a significant impact for patients, ideally using unique capabilities
- Credible academic and medical partners, ideally with a well-organized framework
- Ability to afford the next phase of development, ideally with long-term funding

Source: Interviews with Genzyme executives.

access it needed without compromising the commercial activities that would fund and support the program. (**Exhibit 7** describes Genzyme's R&D operations.)

Like the Gaucher Initiative, HAND created a lot of excitement among employees. Many at the Waltham, Massachusetts, R&D center that housed its projects wanted to contribute, and for the first year or so, researchers mostly worked on the program in their free time. A couple of the first to participate described the excitement: "A lot of people wanted to be on this program, given its social impact. We were just lucky to be among the first employees assigned to projects."

As the exploration of various neglected diseases and potential partnerships expanded, Genzyme found it had to commit more resources to the program. As Klinger described it, "HAND started to transform itself from being a hip-pocket organization to being more formal, almost a shadow organization." From the employees' perspective, this created issues of being recognized for working on HAND. One project member quipped, "I work on a HAND project, but I also report to my regular cost-center manager. It's like working 150%. At the end of the day, I am not even sure my manager knows what my contribution to the HAND program has been."

Furthermore, as key researchers' time and energy were diverted to the HAND program, there was push-back from cost-center managers and project managers. Jim Burns, who managed resources in Waltham, often had to play the role of referee. "The HAND program is the right thing to do and we can add real value in areas like formulation," he said. "But there is a fine balance and we must not overcommit ourselves." Klinger agreed: "Everyone is after scarce technical resources like DMPK (Drug Metabolism and Pharmacokinetics)

Exhibit 7 R&D, Employee, and CSR Indicators at Genzyme

Indicator	Value in Year 2008
Total number of employees	11,000
Total number of R&D employees[a]	~900
R&D employees at the Waltham center (that housed the HAND projects)	205
Total R&D budget	$750 million
R&D budget for drugs and biomaterials devices division[b]	~$80 million
Average fully loaded cost of 1 R&D FTE	~$300,000
Global product donations (for year 2007)	$110 million
U.S. cash donations (for year 2007)	$14 million

[a]The R&D organization at Genzyme has the following locations: (1) Drug and biomaterials R&D focused on small molecules and biomaterial devices (based in Waltham MA); (2) Therapeutic proteins division focused on cell and gene therapies (based in Framingham MA); (3) Molecular antibiotics division based in Cambridge U.K. and two smaller centers in Oklahoma and San Antonio. The Waltham center had around 205 scientists and engineers. Framingham had around 600 R&D employees, while Cambridge U.K., Oklahoma and San Antonio had around 50, 12 and 12 R&D employees respectively

[b]Most of the remaining R&D budget at Genzyme is allocated to the Therapeutic Proteins division

Source: Data on total employees, total R&D budget from http://www.genzyme.com/corp/structure/fastfacts.asp, accessed on August 12, 2009. Data on number of R&D employees in Waltham, R&D budget for drugs and biomaterials, cost of FTE, and other data, from interviews with Genzyme executives.

and medicinal chemistry[c]—commercial project managers as well the HAND program partners. So the question is not just how many resources HAND needs, but what kinds of resources."

HAND in Hand: Engaging Partners

Along with engaging its own internal resources in HAND, Genzyme also began exploring various partnerships that seemed to offer the potential for collaborative research in each of the identified neglected disease areas. It was a slow, iterative process that gradually identified a portfolio of potential long-term research collaborators.

The DNDi Experience In 2006, early in its search for partners, Genzyme initiated discussions with the Drugs for Neglected Diseases initiative. DNDi was a global organization formed in 2003 when five public-sector institutions joined forces with leading NGO Doctors Without Borders and the Special Programme for Research and Training in Tropical Diseases (TDR) sponsored by the United Nations Development Programme (UNDP), the World Bank, and the World Health Organization (WHO).

Given DNDi's expertise in neglected diseases and its worldwide presence, it appeared to be an ideal partner with which to develop and test novel compounds to treat sleeping sickness. In discussions about this possibility, DNDi seemed glad to involve Genzyme, and even proposed bringing additional partners like the Swiss Tropical Institute into the project to do some testing.

However, DNDi was in the midst of a transition, and the new team took a different view of how development should proceed. DNDi was also sponsoring research on other promising sleeping-sickness drug candidates. Soon, the two organizations started moving in different directions on the project.

The relationship remained cordial, and Genzyme continued to use DNDi facilities to test compounds. But while the possibility of future collaboration remained open, by 2008 the two organizations no longer funded projects jointly. For Genzyme, it was an early

[c]Medicinal chemistry is at the intersection of pharmacology and chemistry and involves testing, synthesizing, and developing chemical entities suitable for therapeutic use.

lesson in how difficult it could be to pursue an objective on a project where partners had different interests.

The Broad/Harvard/MMV Negotiations Meanwhile, the malaria work with Broad and Harvard was moving ahead. The Broad Institute would contribute in the area of medicinal chemistry and cheminformatics,[d] the Harvard School of Public Health had expertise in molecular genetics and clinical investigation, and Genzyme would screen its chemical libraries of millions of compounds to check whether any of the compounds were effective in treating the disease targets.

But in this partnership also, differences cropped up—this time over funding. In an initial budget meeting, the partners estimated annual funding needs of about $1.6 million in the first year of the project, increasing to around $6.6 million in year three. Initially, the Broad Institute explored the possibility that Genzyme act as the sponsor for the work at the Broad. After making it clear that they were not in a position to finance the entire program, Genzyme's representatives offered to help raise the money.

The search for both funding and additional capabilities led to the Medicines for Malaria Venture (MMV), a Geneva-based nonprofit organization that focused on the public-private partnership model involving academics, NGOs, and pharma companies like Novartis and GlaxoSmithKline (GSK). With $263 million in funding (much of it from the Gates Foundation), MMV was looking for new partners, and the Broad-Genzyme-Harvard partnership looked very attractive, given the credibility of the partners and their complementary skills. Soon, Genzyme and its partners received funding of $4 million from MMV and began work on five projects focused on malaria.

Looking back, Geraghty saw the early tension with Broad as a blessing in disguise. "It was a pleasant surprise to learn that we also could get funding," he said. "It freed us to contribute our people and technology to the program, without the constraint of funding it 100% ourselves."

[d]Cheminformatics is at the intersection of chemistry and computer science and involves storing and retrieving data related to molecules and compounds.

The Fiocruz Relationship In 2006, soon after the HAND program was announced, Latin American general manager Rogerio Vivaldi opened discussions with the Oswald Cruz Institute or Fiocruz, a Brazilian public science organization that was part of the Ministry of Health. It conducted research, produced vaccines, and was involved in public health education. Fiocruz had previously approached Vivaldi with a request for the technology to produce Cerezyme (a later version of Ceredase) in Brazil. Vivaldi had responded by saying that perhaps the two organizations could create more value by working together on neglected diseases like Chagas.

To explore this possibility, Vivaldi proposed sending Fiocruz scientists to Genzyme's Waltham R&D center to learn how to take new therapies through the drug development process. From Genzyme's point of view, while the visit provided a way to get to know this potential partner, it was not without its challenges. "Our most valuable resource is the time and energy of our scientists and those who manage them," said Geraghty. "Clearly a partnership with an organization like Fiocruz makes more of a demand on that resource than a local partnership, but our scientists also learn from it."

The TB Alliance Discussions As Geraghty continued his discussions with the Global Alliance for TB Drug Development (or the TB Alliance, as it was known), he learned that it was a product development partnership that operated like a virtual biotechnology firm. It had significant financial support from the Gates and Rockefeller foundations as well as several governments worldwide, and used those funds to outsource the development of potential drugs to pharmaceutical companies like Bayer and GSK. However, unlike traditional product development in those companies, the clear objective of these projects was to create treatments that were both affordable and accessible to the developing world.

As an initial project, the TB Alliance proposed funding a specific research program in which Genzyme would take responsibility for screening some existing targets by allocating scientists with DMPK and medicinal chemistry skills to the project.

Geraghty indicated that these were scarce resources at Genzyme, but that he would take the proposal to the company for consideration.

Extending the HAND: Exploring New Opportunities

After almost three years, HAND's activities were beginning to coalesce around the malaria and Chagas projects. But as Geraghty and the HAND steering committee began talking about the program's future, they wondered if they had identified the most appropriate neglected diseases, were engaged in the most effective partnerships, and were applying the most appropriate resources to the program. With a review in process, advocates and champions for each of the options quickly arose.

The Chagas Project: A Champion in Brazil As soon as the HAND program was announced, Vivaldi had seen an opportunity to link this initiative to the growth of Genzyme's operations in Brazil. Vivaldi was a doctor who had treated Brazil's first Gaucher patient in 1991. After Genzyme opened an office in São Paolo in 1997, Vivaldi had painstakingly built up the operations and had elevated Genzyme Brazil into the top tier of pharmaceutical companies in the country, with 100 employees on its rolls.

While Genzyme Brazil was in a start-up mode, José Serra, São Paulo's mayor, was positioning himself as a presidential candidate in 2002. National health-care reform was a priority for Serra, widely credited with boosting the generics industry in Brazil and creating ANVISA (Agência Nacional de Vigilância Sanitária), the Brazilian food and drug regulatory agency. In this context, Vivaldi succeeded in getting Cerezyme on the list of exceptional drugs for rare diseases, thereby ensuring direct reimbursement from the federal government. In 2008, $100 million of the $108 million in revenues that Genzyme had in Brazil came from federal reimbursements. "Brazil has created a template for emerging markets in Latin America, South Asia, and Eastern Europe," said Geraghty. "We were able to convince governments in countries like Chile and Venezuela to follow the example of Brazil and create programs that supported the treatment of Gaucher."

Still, retaining Cerezyme's place on the coveted list wasn't easy. "There were health-care officials who claimed that they could eradicate tuberculosis in Brazil with the money being a directed into Gaucher," Vivaldi explained. "What really helped us was our commitment to treating poor patients under the Gaucher Initiative and our direct communication with the government." But the list for "exceptional drugs" was coming up for a revision in 2011, and more than 100 drugs had staked their claim to be included, including 5 from Genzyme. To Vivaldi, the HAND project represented an important means of raising Genzyme's profile ahead of that decision.

Following Geraghty's meeting with a leading Fiocruz scientist, Vivaldi began exploring with his Brazilian partner how the two organizations might work together in other disease areas like malaria and tuberculosis. Within Genzyme, he became an extremely strong and passionate advocate for such extended partnership activity.

On the January 2009 HAND conference call, Vivaldi was very upbeat about the Chagas initiative, which he emphasized would be a true giveback to Brazil. He also reminded them that several Brazilian Health Ministry officials had involvement with Fiocruz, and that continued success in the project would enhance Genzyme's credibility with federal health authorities, a particularly important objective, given that the list of federally approved drugs would soon be updated.

The Malaria Initiative: Lobbying in India On the other side of the world, Sandeep Sahney, managing director of Genzyme India, was equally excited about HAND. Genzyme had entered India in 2002 when it launched Synvisc, a biotech product indicated for the treatment of osteoarthritis of the knee. In 2007, the company hired Sahney, a local industry veteran, to build the organization.

Genzyme was still in a start-up mode in India, compared to its position in Brazil. Even though the government had no program to reimburse Gaucher patients, Genzyme hoped to generate sales of $30 million to $50 million within five years. But without government reimbursement, most of this growth would have to come from sales of treatments for

cancer, osteoarthritis, and renal disease to private-practice doctors and for-profit hospitals.

But Sahney also believed that Genzyme had another great untapped opportunity in India—to access world-class R&D resources in government and private labs. He felt that the HAND program provided the ideal platform to bring together resources and ideas across various local labs and tap into that knowledge. Supported by Geraghty and Sybertz, Sahney spent much of 2007 and 2008 in discussions with several Indian public science organizations, like the Council for Scientific and Industrial Research. "The Indian scientific community has great talent, but its people work in silos," Sahney said." Genzyme could help break some of the walls."

Given malaria's widespread occurrence in India, Sahney saw HAND providing an opportunity to begin discussions with ICGEB, a Delhi-based organization working on developing a new vaccine for the disease. "ICGEB is funded by the United Nations and the Indian government, and has great skills in vaccines," Sahney reported. "It has been working on malaria vaccines for 15 years and has deep knowledge of local issues, like how the disease is spread here."

ICGEB also had new expertise to contribute to the project. Most human malaria is caused by two distinct species—*Plasmodium falciparum* and *Plasmodium vivax*. Though most of the existing malaria research (including the Broad-Harvard initiative) was focused on the former, in India 65% of the disease cases were attributed to the latter. This lesser-researched species appeared to have caused more virulent disease in recent years, and ICGEB had demonstrated novel ideas for targets and certain plant-based treatment strategies effective for both *vivax* and *falciparum*.

Genzyme decided to explore this potential partnership, and it was agreed that ICGEB, like Fiocruz, would get rights to all the intellectual property (IP) that came out of the program in the field of neglected diseases. But early communication problems with the new Indian collaborators underscored how challenging cross-border partnerships could be. Klinger recalled, "On an early video conference call, I was bringing the discussion to a close by listing the seven initiatives that seemed to interest people. But when I asked for suggestions about how to prioritize them, someone on the Indian side said, 'It's very inefficient to prioritize. Why not do all of them at the same time?' At that point, it was clear that our approaches might be different."

Meanwhile, Genzyme had committed to a partnership with Advinus, an Indian research company with great skills in chemistry, DMPK, and crystallography. But the deal with Advinus was fundamentally different from that with ICGEB: the partner would be paid on an hourly basis for specific assignments, and its services would be used on an "as needed basis" by multiple HAND program teams, including the Broad and Harvard malaria research team.

With time, the ICGEB relationship had overcome some of the initial cultural barriers, and on the conference call, Sahney was passionate about the need to support this emerging partnership. He explained that malaria, especially the *vivax* strain, was a real unsolved problem in India, and ICGEB had shown great promise by coming up with concrete ideas on molecules that could be tested. He firmly believed that success in this project would position Genzyme as an "Indian" R&D player and build its reputation with the local medical and research communities. Sahney also suggested that the Indian malaria template could be used in other countries like Brazil and in parts of Africa.

The TB Option: A Voice in the Center Meanwhile, at Genzyme's Cambridge, Massachusetts, headquarters, Geraghty wanted to keep questioning the assumptions and challenging the priorities that shaped HAND's future direction. In that role, one of the issues he had kept alive was the question about whether Genzyme could devote resources and capabilities to helping develop treatments for TB.

A year after Geraghty's initial contact with the TB Alliance in 2006, the CEO with whom he had been having discussions resigned and the relationship stalled. In 2008, at a Gates Foundation meeting, he struck up a conversation with the new CEO, and promptly invited him to visit Genzyme. "We sat down with scientists from both organizations to discuss collaborative possibilities," said Geraghty. "We all learned a lot, but had difficulty finding a way

to get started. Beyond our normal worry about being stretched too thin, some of our people expressed concerns that we did not know much about TB. But as I pointed out, we didn't know much about malaria either until the HAND program started."

About this time, Geraghty was also contacted by scientists working on TB at the Harvard School of Public Health (led by outgoing dean Barry Bloom, a world authority on TB) and at the Broad Institute. The scientists had developed novel assays and had identified unique targets for TB drugs using sophisticated genomic analyses and felt that Genzyme could help move them forward, as in the case of malaria. Geraghty offered assistance on project management, but the relationship did not develop. Still, it was a potential resource that might be engaged in the future.

One question the HAND steering committee faced was deciding which neglected diseases offered the most effective use of its scarce resources going forward. By this criterion, TB demanded attention because it was such a massive global health-care problem. In comparison, the number of people affected by Chagas was relatively small and its impact was focused on Central and South America (see **Exhibit 5**).While malaria was more widespread and had higher morbidity and mortality rates, it had recently attracted significant funding and technological resources, particularly due to its priority status within the Gates Foundation. One outcome of this was that in early 2009, Bill Gates announced a potential breakthrough vaccine that could be ready by 2014.[2] Given the large number of global players and the significant resources aimed at malaria's cure, some industry observers had begun questioning whether it could still be classified as a "neglected disease."

In contrast, despite the fact that TB was a worldwide problem with among the highest mortality rates, it received much less global attention. In that context, Geraghty wondered whether Genzyme should restart discussions with the TB Alliance, the Harvard School of Public Health, and the Broad Institute. "I remain a champion for HAND to consider TB because I think it is good if we keep questioning how we are using our scarce resources," he said. And a project with partners based in New York and Boston could be a lot easier to manage than one linked into Brazil or India.

[2]Gates Foundation, annual letter, p. 15, http://www.gatesfoundation.org/annual-letter/Documents/2009-bill-gates-annual-letter.pdf, accessed August 15, 2009.

On One HAND: Weighing the Options

After presenting their cases, the two invited guests dropped off the conference call, leaving the steering committee members to review some of the other opportunities and risk factors they would have to take into account in making their recommendations about HAND's future direction and priorities.

END of U.S. Government Inaction On the positive side, Genzyme and its partners had received good news from Washington, where the U.S. Senate had recently adopted the Elimination of Neglected Diseases Act (END) amendment to the Food and Drug Administration Reauthorization Bill. The END Act would award a "treatment priority review voucher" to any company that brought to market a treatment for a neglected disease.

The voucher, which could be used for any new drug coming up for review, would ensure that an FDA priority review could be completed in about 6 months compared to 18 months under a regular review. The 12 months saved could be worth up to $300 million to a pharma or biotech company—perhaps more for a blockbuster drug. Senator Sam Brownback commented: "We are blessed to live in a nation in which diseases like malaria and cholera are not serious threats, but must not forget that one-sixth of the world's population faces death and suffering from easily treatable diseases... Private companies have the potential to be major players in the fight against neglected diseases."[3]

The IP Risk: The Novartis Experience Of greater concern to the HAND steering committee were developments involving an ongoing patent dispute between Novartis and the Indian government. After Indian regulatory authorities refused to grant Novartis a patent on its cancer drug Glivec, Novartis

[3]News release,"Brownback Applauds Adoption of Neglected Diseases Amendment" September 21, 2007, http://brownback.senate.gov/public/press/record.cfm?id=283848, accessed August 15, 2009.

had taken legal action challenging India's 2005 law, which allowed patents to be refused for drug modifications that could not prove significant increases in the original drug's efficacy. The company contended that this was in violation of WTO rules relating to trade-related intellectual property rights.[4]

The appeal created headlines, causing several NGOs to strongly criticize Novartis's actions. For example, a spokesman for Doctors Without Borders, an organization that relied on India as a source of 84% of its generic AIDS drugs, said, "People the world over who rely on India as a source of their medicines may be affected if Novartis gets its way."[5] After pointing out that 99% of patients treated with Glivec in India received it free from Novartis, a company spokesman said, "Our actions in India do not hinder the supply of medicines to poor countries given the international safeguards now in place. We are seeking clarity about India's laws... We believe that limiting patents only to new chemical entities does not recognize genuine innovation. Medical progress happens through steps in innovation, also called incremental innovation."[6]

Through its contact with Novartis at MMV, Genzyme had become increasingly aware of the company's commitment to finding cures for neglected diseases. In addition to its involvement in nine MMV projects, it had created its own nonprofit Institute for Tropical Diseases in collaboration with the Singapore Economic Development Board. But, apparently, these commitments to developing countries' needs had not carried much weight with the Indian government.

As corporate counsel, Peter Wirth was concerned about these developments. Previously a respected partner at a Boston law firm, Wirth was known to ask difficult but insightful questions within Genzyme. "While most of us would be looking at the bright side, Peter would be thinking of the potential risks and pulling us back to reality," said Geraghty. Taking that role, Wirth challenged the HAND committee to think about what implications the Novartis case held for Genzyme—its relationships with India, its intellectual property positions, and even its altruistic motives.

The question led Geraghty to reflect on a recent Gates Foundation discussion about how to stimulate more corporate research involvement in neglected diseases. The two major impediments cited by most companies were the difficulty of making money in neglected diseases and the fear of losing control of their intellectual property. Rightly or wrongly, they believed some developing countries did not have the same respect for IP as most developed countries did.

The Management Challenge: Managing Partnerships and Expectations Wirth also articulated concerns about "setting the right expectations" with Genzyme's various partners, especially those in developing countries where each party's future hopes and expectations were not always made clear. He recalled that during the Gaucher Initiative, its government and NGO partners had expressed strong concerns when Genzyme eventually applied for partial reimbursement for supplying Cerezyme to patients in Egypt when the local health-care system could eventually afford it. This had led to tensions and disputes that Wirth did not want to repeat.

In his opinion, Genzyme would have to clearly define upfront where it could help and where it could not. However, with the barriers of language, culture, and distance, Wirth saw lots of opportunity for miscommunication. "It will be imperative for us to etch a strong impression in the minds of partners, governments, and the public at large of our constraints and limitations," he said.

Geraghty too was concerned about the increasing network of complex partnerships. Although the initial start-up challenges with DNDi and Broad had taught him important lessons, over the last couple of years, HAND had added many more partners to its projects. The sleeping sickness team now included Pace University in New York, the Swiss Tropical Institute, and most recently, Fiocruz in Brazil. In addition to Broad and Harvard, the malaria initiative now involved ICGEB and Advinus, with

[4] http://www.medicalnewstoday.com/articles/61932.php, accessed August 15, 2009.

[5] http://doctorswithoutborders.org/press/release.cfm?id=1870, accessed August 15, 2009.

[6] Novartis release, http://www.novartis.com/downloads/about-novartis/Novartis_position-Glivec_Gleevec_patent_case_india.pdf, accessed August 15, 2009.

Fiocruz showing interest. "It takes a lot to manage all these relationships," said Geraghty. "Maintaining the managerial bandwidth to deal with this level of complexity is very challenging."

The Resource Decision: Allocating Funds and Capabilities HAND had moved far beyond the part-time volunteer staffing of its early days, and by 2009, there were around 10 employees in Waltham working virtually full-time on its projects. With the fully loaded cost of an employee at around $300,000, this was an annual investment of around $3 million. In addition, Klinger's title was now vice president of infectious diseases and neglected diseases, with

Exhibit 8 Malaria–Scientific Strategy and Skills of Partners

Recent scientific breakthroughs

- Sequencing of multiple strains of *P. falciparum* has provided information on available targets and their diversity.
- High-density genetic mapping (HapMap) has enabled detailed mapping of genes responsible for disease severity and drug resistance.
- New drug-discovery efforts focused on Protease inhibators.

	Novel Target Discovery	Compound Screening	Lead Selection & Optimization	Preclinical Development	Clinical Trials & Approvals
Genzyme	Support role	Lead role: make libraries comprising millions of compounds available for screening to find 'hits' with target	Lead role: design and synthesize hundreds of analogues of 'hits' to improve property of 'hits'	Lead role: confirm potency and safety of drug using animal and lab tests	Support role
Broad & Harvard	Lead role: lead biology research in identifying potential intervention points (targets) for the disease	Lead role: contribute library of 120,000 compounds to screen compounds to screen for anti-plasmodial activity using Kan reactors	Lead role: share medicinal chemistry effort with Genzyme	Lead role: share cheminformatics effort with Genzyme	Support role
MMV	Support role	Support role	Support role	Support role	Lead role: organize testing and animal models
ICGEB	Lead role: target ideas for vivax and falciparum	Support role	Support role	Support role on chemin-formatics	Possible support role

Source: Interviews with Genzyme executives.

the latter designation reflecting the amount of time and attention he was now giving to HAND.

Watching this growing activity, Wirth questioned whether Genzyme could sustainably invest the financial and human resources to manage multiple programs and partners. He urged the committee to balance global medical need with the best fit of technology and partner (**Exhibits 5, 8,** and **9** provide data). He also worried that pursuing too many initiatives would lead to less oversight and therefore greater risk.

• • •

With all this advice ringing in his ears, Geraghty knew that the time for analysis was over. Now was the time for decisions. Termeer would be expecting the HAND steering committee to provide some clear proposals about which projects to undertake, which partners to engage, and what resources to allocate to them.

Exhibit 9 Chagas–Scientific Strategy and Skills of Partners

Recent scientific breakthroughs

- Two focus areas: (1) Identifying novel biological targets within the parasite that causes Chagas disease; (2) Test effectiveness of using monoclonal antibodies to neutralize a protein that contributes to heart damage in Chagas disease.
- New drug discovery efforts focused on Megazol Analogs.

	Novel Target Discovery	Compound Screening	Lead Selection & Optimization	Preclinical Development	Clinical Trials & Approvals
Genzyme	Support role	Lead role: make libraries comprising million of compounds available for screening to find 'hits' with target. Also test compounds that have been effective in sleeping sickness parasite	Lead role: design and synthesize hundreds of analogues of 'hits' to improve property of 'hits'	Lead role: confirm potency and safety of drug using animal and lab tests	Support role
Fiocruz	Lead role: scientists at Fiocruz have developed metabolic maps of the Trypanosoma cruzi parasite that causes the disease; these maps will be used to explore specific metabolic pathways that may serve as targets for potential drugs	Support role	Support role	Support role	Support role

Source: Interviews with Genzyme executives.

Reading 8-1 A Global Leader's Guide to Managing Business Conduct

by Lynn S. Paine, Rohit Deshpandé, and Joshua D. Margolis

Managers working outside their home environments often find that their companies' norms are inconsistent with practices followed by other businesses in the area. In response, many follow the time-honored advice given in the fourth century by the bishop of Milan to Augustine of Hippo: When in Rome, do as the Romans do.

But that's a perilous approach. Consider the outrage in the United States when the media reported that BP oil rigs in the Gulf of Mexico lacked safeguards required on similar machinery in Norway and Brazil—even though the failed equipment in the Gulf met U.S. legal requirements. Or the worldwide outcry over working conditions at Foxconn in China after some employees committed suicide, although the company's factories were arguably no worse than thousands of others nearby. Or consider the hot water that Siemens, Lucent, and DaimlerChrysler landed in after paying bribes and making various types of side payments that were common in the countries where the companies were operating.

These and other incidents show that conformance with local law and practice does not guarantee stakeholder or public approval of a corporation's behavior. But does that mean companies should automatically default to their home-country practices?

Our research suggests that the answer is no. In surveys of more than 6,200 employees from the top ranks to the front lines of four leading multinationals based in the U.S., Europe, and Japan, we found a strong consensus on basic standards of conduct that companies should follow worldwide. Our findings indicate, further, that meeting those standards will require new approaches to managing business conduct. The compliance and ethics programs of most companies today fall short of addressing multinationals' basic responsibilities—such as developing their people or delivering high-quality products—let alone such vexing issues as how to stay competitive in markets where rivals follow different rules. Instead of intensifying their focus on compliance, companies must bring to the management of business conduct the same performance tools and concepts that they use to manage quality, innovation, and financial results. Leaders need an approach that is guided by global standards, informed by systematic data, grounded in the business context, and focused on positive goals.

This need is particularly acute right now. Despite the widespread adoption of ethics programs by companies around the world in recent decades, failures of corporate responsibility are all too frequent and public trust in business remains distressingly low. At the same time, expectations continue to rise. The UK created a new antibribery law that took effect July 1, 2011, and broadens the range of companies—both domestic and foreign—that can be prosecuted in the UK for bribery or for failure to prevent bribery by an associated person or entity, regardless of where the offending act took place.

In this article, we offer guidelines for navigating the increasingly rugged ethical terrain that multinationals face every day.

Identify Your Conduct Gaps

Government officials and members of the public aren't the only ones calling for better business conduct. Employees, too, see a need for improvement in corporate behavior. Surveys we conducted in 2006 and 2007 at some of the world's leading global

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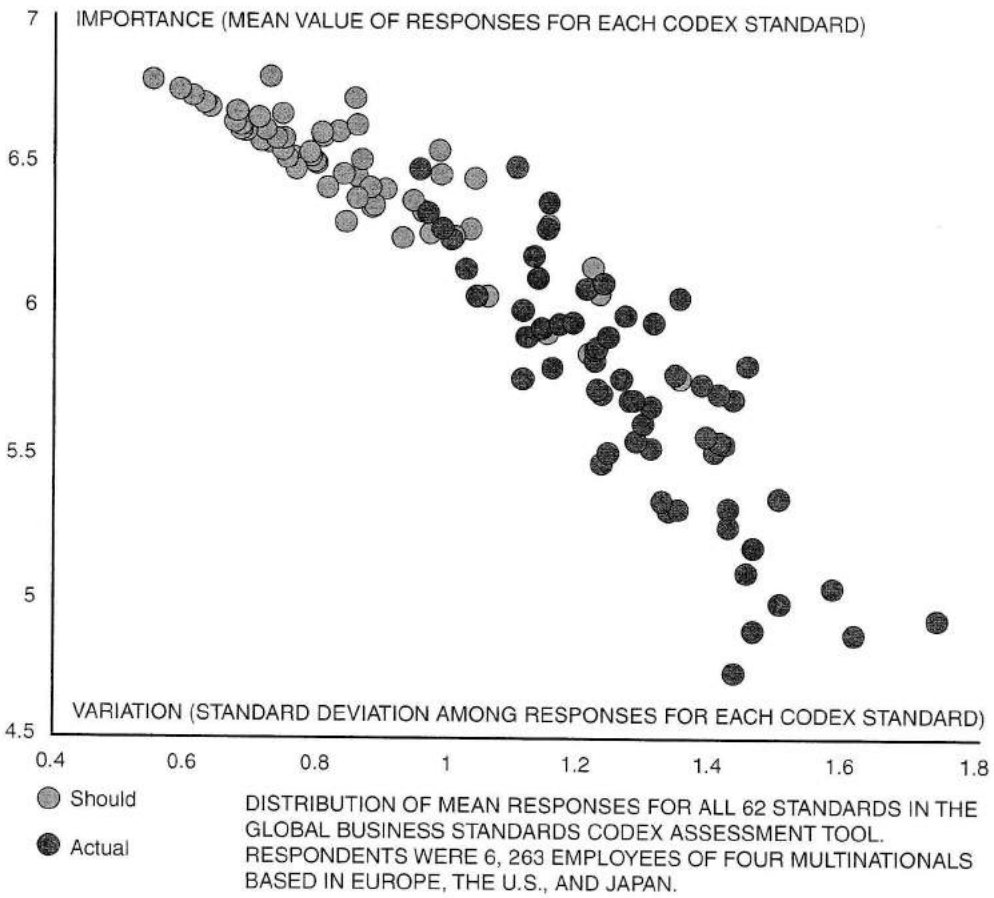
corporations reveal that while there is a strong consensus on the standards that should be met, many employees feel that their companies don't fully live up to those standards. (See the exhibit "The Conduct Gap.")

The Conduct Gap

Surveys we conducted at leading multinational corporations show that employees tend to agree on what companies should do, but many believe their employers don't fully live up to those standards; we also found greater consensus among employees on what companies should do as compared with what their own companies actually do.

The surveys, whose findings have been supported by a companion study of global executives that has 880 respondents to date, show that employees from every level in those organizations strongly support adherence to the 62 standards in the Global Business Standards Codex, which we developed some years ago on the basis of leading codes of corporate conduct. These standards, described in our 2005 HBR article "Up to Code," cover all of a company's responsibilities, from respecting employees' dignity to refraining from bribery to creating innovative products and technologies.

Despite wide differences in cultural origins and business environments, the employees, when asked



DISTRIBUTION OF MEAN RESPONSES FOR ALL 62 STANDARDS IN THE GLOBAL BUSINESS STANDARDS CODEX ASSESSMENT TOOL. RESPONDENTS WERE 6, 263 EMPLOYEES OF FOUR MULTINATIONALS BASED IN EUROPE, THE U.S., AND JAPAN.

the extent to which they thought companies should adhere to each of the standards, responded with an average value of 6.44 on a scale of 1 to 7. Even on items that we thought would be controversial—such as respecting dignity and human rights—we found strong support. These surveys bolster our earlier research, in which we hypothesized an emerging consensus on widely accepted standards of conduct for global companies, and they belie the assumption that relativism should guide cross-border business practices.

But the gap between "should" and "do" was troubling: The average score on adherence to the standards was just 5.68 on the same seven-point scale. Moreover, we found a greater range of responses on the actuals than on the shoulds, which means employee perceptions of what their companies do are more varied than their perceptions of what the companies should do. Although every company will have a different profile of gaps between its conduct and what employees feel that conduct should be, we observed three patterns that we suspect are widespread.

The altitude effect. Those at the top of the corporate hierarchy generally have a more positive view of their companies' conduct. For the bulk of the standards, respondents who identified themselves as corporate or division-level executives reported smaller gaps between "should" and "do" than those who identified themselves as middle management, junior management, or non-management employees. The altitude effect was most pronounced for employee-related issues, but it was also strongly in evidence for basic standards of business integrity such as fair dealing and promise keeping and for basic standards of human welfare such as protecting health and safety. Whether the rosier view from the top indicates that executives are better informed or that they are merely out of touch, the discrepancy between their assessments and those offered by other employees is cause for some concern. At the very least, it indicates that executives need to rely on more than their own views to assess their companies' ethical performance.

Basics matter. We found that gaps for standards of business integrity were among the widest. Although environmental issues emerged, somewhat predictably, with wide gaps, we also found larger-than-average gaps for fair dealing, promise keeping, and conflict-of-interest disclosure. These findings are a reminder that business leaders must remain vigilant about basic business integrity even as they strive to meet emerging standards of corporate citizenship concerning the environment, human rights, and supplier practices.

Employees are an early-alert system. Gaps relating to fair compensation, responsiveness to employees' concerns, communication with employees, and developing employees' skills topped the list. In the next tier, not far below, were gaps relating to free association, employee dignity, equal employment opportunity, and employment dislocations. Employees may well be most sensitive to practices that affect them, but that shouldn't provide much solace to executives. A large body of research has consistently shown that employees who feel mistreated exact a cost from the company, and many companies espouse the importance of treating employees the way they want employees to treat customers. The sizable gaps we found on employee standards may be an early warning of brewing trouble.

Develop Data-Driven Tools

With governments, the public, and employees expressing a desire to see better corporate behavior, how can companies take measurable steps to improve their conduct?

While many executives say that their companies adhere to the highest ethical standards, very few have data to assess the stringency of those standards or even a way to determine what standards their companies actually follow. Instead they typically point with pride to the company's written code, the excellent people the company hires, or how some particular misdeed was handled.

Such unsubstantiated claims would be unacceptable in any other aspect of business. An executive who claimed that his company's sales were among the best in the industry but whose only evidence was the company's written sales plan, its great salespeople, or

last week's big sale would quickly be shown the door and perhaps even sued for fraud or negligence. The lack of data and rigor in assessing and managing business conduct is tolerated because many assume that ethics and conduct are "soft" topics not amenable to measurement or evaluation.

To be sure, many companies do track the use of their hotlines and collect data on alleged code-of-conduct violations. And some companies do survey employees on their perceptions of company values or adherence to espoused standards. What is largely lacking, however, is a systematic approach to assessing company performance on the standards of conduct that are expected of leading companies today.

To address this problem and help leaders more accurately gauge their companies' ethical performance, we developed an assessment tool based on the Global Business Standards Codex to survey the four global companies. Compared with more-common assessment tools, this one has several important features. First, it is based on objective rather than subjective standards (those that the company has chosen) that we have found to be widely accepted by diverse business, government, and multisector groups. Second, it generates data from throughout the company—up and down the hierarchy and across multiple units—and covers multiple dimensions of performance. Third, it focuses not just on negative standards and the prevalence of misconduct but on positive standards and the company's performance against affirmative benchmarks.

The codex assessment tool allows business leaders to construct an organization-wide picture of the company's ethical strengths, weaknesses, and performance. Admittedly, it captures perceptions and beliefs rather than actual behavior, and perceptions can be mistaken. (An independent third-party assessment would be useful additional input.) But perceptions from a broad and diverse group of employees are a useful first approximation of actual conduct—and perceptions are crucial in and of themselves, because they drive attitudes and opinions within the company. They are also useful for helping managers take three necessary steps: identifying issues that need further inquiry, pinpointing potential risks to the company and its reputation, and finding areas of strength and opportunities for learning.

The Global Business Standards Project

In response to a lack of clear, comprehensive guidelines for the conduct of global companies, we set out in 2004 to create a business-ethics index that companies could use to benchmark their behavior over time.

As a first step, we systematically analyzed a select group of codes of corporate conduct. Distilling precepts from 23 sources, including 14 of the world's largest companies and institutions—among them the United Nations, the OECD, the Global Reporting Initiative, and the Caux Round Table—we created the Global Business Standards Codex, a compilation of widely endorsed standards.

We then conducted multilanguage field surveys to determine the extent to which businesspeople around the world believe that companies should—and do—adhere to these standards. Two data sets emerged from this work, which drew on respondents from some 23 countries and regions: findings from 880 executives in Harvard Business School's Advanced Management Program (2006 to the present), and survey results from more than 6,200 employees of four leading global companies (2006 and 2007).

Go Beyond Compliance-as-Usual

Over the past two decades, many executives have appointed chief compliance officers and established programs to foster adherence to their companies' codes of conduct. A typical compliance program comprises best-practice elements—from a defined set of conduct standards and policies to an implementation and oversight structure that goes all the way up to the board of directors, often via the board's audit committee or a compliance committee. Companies that follow such programs communicate their standards to employees, appoint ombudspeople, set up anonymous hotlines, and install monitoring and auditing processes to ferret out code violations and risks. They are quick to respond to violations by going after the causes and the offenders.

These programs are predicated on a well-functioning legal system, and their approach to influencing behavior relies heavily on the lawyer's tool kit of rules and penalties. Violations are presumed to originate with individuals acting against otherwise prevailing norms, so the idea is to detect and deter breaches by fostering transparency and strengthening disincentives. The apparatus is focused on activities inside the organization and is largely indifferent to the economic and societal context in which the organization operates. Moreover, it is much the same whatever the business and whatever the content of the code.

But this approach seems markedly out of step with other areas of business practice. Our research suggests the need for richer tools and a more contextual approach to improving ethical performance. When we delved more deeply into the gaps between "should" and "do," we found that aspects of the broader context in which respondents were working related to the size of the gaps they reported. In particular, we found that employees in the emerging markets of China, India, Brazil, and Southeast Asia reported larger gaps than those in the United States, the UK, Western Europe, and Japan. More generally, those in low-income countries reported larger gaps than those in middle- and high-income ones. The discrepancy between emerging and developed markets was in evidence across a wide range of areas—from competitive practices and employee development to community relations and anticorruption efforts. In only one area—providing customers with accurate information about products and services—did developed-market respondents report significantly larger gaps than emerging-market respondents.

Gaps associated with broad contextual factors such as the economic and legal environments are difficult to address with a compliance program focused on detecting and deterring individual violators. For such factors, low adherence to the codex standards may have more to do with the environment in which people are working than with deficiencies in the character or motivation of particular individuals, so replacing one set of employees with another is unlikely to make much of a difference. What's needed is a multifaceted response that takes account of how legal or economic differences shape behavior and support (or discourage) adherence to the standards in question.

Consider the large gaps for workplace health and safety that we found in some regions. As many companies have learned, an effective program for improving workplace safety may include investment in equipment and infrastructure, redesign of facilities, changes in work processes, education and training of employees, and modification of performance measures. Engagement with external parties—to establish standards, improve enforcement practices, and focus public attention on safety—may also be required. None of these elements is included in the typical compliance tool kit.

Similarly, efforts to combat bribery in an environment where corruption is widespread must be multifaceted. Instructing employees to "just say no" and punishing violators may work, but it carries a risk to the business and may drive corruption further underground. A more promising approach recognizes that the best protection against corruption is a superior product that adds value for the customer and is not readily available elsewhere. Excellent sales and marketing skills are also important, because without them sales personnel are much more dependent on supplying personal favors, gifts, and entertainment. As in the case of workplace safety, changes in internal processes may be required—for example, approvals for certain marketing expenses—and it may be essential to engage with external parties such as standard setters, regulatory officials, and anticorruption groups.

The usual compliance tool kit is useful for reinforcing certain standards in certain operating environments, but as these examples show, business leaders will need a much more extensive set of tools to improve performance in many of the gap areas identified by our research. It is not enough to establish codes of conduct, oversight structures, reporting processes, and disciplinary systems. Managers also need to examine core aspects of the business and the operating environment and craft a performance-improvement plan that is tailored to those specifics

using the full range of management tools at their disposal—from product, process, and plant design to employee training, development, and motivation; marketing strategy; external relations; and community engagement. Leaders must change the context within which people are working. To do so, they will need to go well beyond the activities performed by the typical compliance and ethics function.

Revise Your Mental Model

Many executives who are serious about business conduct view the challenge with the legalistic mentality that informs most compliance programs. This mentality is characterized by binary categories—ethical versus unethical, compliant versus noncompliant, legal versus illegal—that leave little room for degrees of performance or gradual improvement. It focuses on standards requiring or prohibiting actions that can be readily specified in advance, such as rules against bribery, insider trading, or collusion among competitors. Executives in this camp sometimes pride themselves on having zero tolerance for unethical behavior or for insisting that ethics are nonnegotiable; compliance must be immediate, and it must be complete.

Although compliance thinking and zero tolerance have their place, our research underscores the need for business leaders to see a profile of corporate conduct that is broad, dynamic, and affirmative.

By broad, we mean including not just "Thou shalt not . . ." but also the standards that have traditionally been called "imperfect duties." Unlike legalistic standards that require specific acts or omissions, imperfect duties allow for a significant degree of freedom in how they may be satisfied. Consider, for example, the codex standards on respecting employee dignity and on fair treatment of minority shareholders. The actions required to meet those standards cannot be easily stated in generic, auditable terms. A full third of the codex standards are of this indefinite type. (One-third are definite, and one-third are of a mixed character.) We found that in general, gaps are larger for indefinite than for definite standards. Indeed, among the largest gaps revealed in our multinational surveys, about half were associated with standards that are indefinite or mixed in nature—for example, providing employees with fair compensation, protecting the environment, helping employees develop skills and knowledge, and, among emerging-market respondents, cooperating with others to eliminate bribery and corruption. A company stuck in a compliance mind-set may be patrolling violations effectively while missing out on crucial opportunities to upgrade its performance in these ethical areas.

By dynamic, we mean capturing how performance shifts over time. As macroeconomic and industry conditions change, the pressures and opportunities that shape individual and company conduct also change. Periodic assessments of how the company is performing on the codex standards are crucial for spotting emerging risks and opportunities.

By affirmative, we mean treating ethics as goals to strive for rather than just lapses to avoid. Business leaders will need to think in terms of continuous improvement as they seek to create the conditions and institutions necessary to support adherence to the whole range of codex standards across differing operating contexts.

A broad, dynamic, and affirmative approach to managing business conduct represents a new way of looking at corporate ethics. For companies to foster this new way, a corporate-conduct dashboard may prove essential. Using data gathered with the codex assessment tool, managers can provide a snapshot of the company's performance on key indicators to make conduct issues across the organization visible to business leaders. The data can be aggregated in various ways. For instance, they can be organized to show the extent to which employees support the "should" consensus or how employees rate the company's performance on ethical principles or responsibilities to stakeholders.

The dashboard can also convey the largest gaps as seen by employees across the company and within different business units, regions, functions, and hierarchical levels. Depending on how the data are analyzed, it can allow for more-granular comparisons of gaps for particular standards—or topic areas—across various geographies and business

units. For instance, results for the cluster of standards relating to the environment can be aggregated, and an indicator for environmental issues in different regions can be included in the dashboard.

A codex dashboard is only the beginning of a conversation. To understand what accounts for the findings that it captures, managers and directors will need to look beneath the surface and to interpret the indicators with care and judgment in light of other facts and data. Still, a codex dashboard can help executives shift from what they sense to what systematic data reveal and from a compliance-oriented review of hotline usage, investigations, and disciplinary actions to a more holistic examination of the company's overall performance on critical standards. Instead of debating whether a spike in reported cases is good (because it shows that employees are not afraid to use the reporting system) or bad (because misconduct is, in fact, escalating), business heads and board members can focus on where the threats and opportunities may lie and how the company can achieve its conduct goals.

With an enriched tool kit and new ways of thinking, business leaders can, we hope, improve their companies' ability to perform to the standards increasingly expected of multinationals the world over. We think that doing so is crucial for maintaining the public's trust in business and the free-market system.

Reading 8-2 Serving the World's Poor, Profitably

by C.K. Prahalad and Allen Hammond

Consider this bleak vision of the world 15 years from now: The global economy recovers from its current stagnation but growth remains anemic. Deflation continues to threaten, the gap between rich and poor keeps widening, and incidents of economic chaos, governmental collapse, and civil war plague developing regions. Terrorism remains a constant threat, diverting significant public and private resources to security concerns. Opposition to the global market system intensifies. Multinational companies find it difficult to expand, and many become risk averse, slowing investment and pulling back from emerging markets.

Now consider this much brighter scenario: Driven by private investment and widespread entrepreneurial activity, the economies of developing regions grow vigorously, creating jobs and wealth and bringing hundreds of millions of new consumers into the global marketplace every year. China, India, Brazil, and, gradually, South Africa become new engines of global economic growth, promoting prosperity around the world. The resulting decrease in poverty produces a range of social benefits, helping to stabilize many developing regions and reduce civil and cross-border conflicts. The threat of terrorism and war recedes. Multinational companies expand rapidly in an era of intense innovation and competition.

Both of these scenarios are possible. Which one comes to pass will be determined primarily by one factor: the willingness of big, multinational companies to enter and invest in the world's poorest markets. By stimulating commerce and development at the bottom of the economic pyramid, MNCs could radically improve the lives of billions of people and help bring into being a more stable, less dangerous world. Achieving this goal does not require multinationals to spearhead global social development initiatives for charitable purposes. They need only

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act in their own self-interest, for there are enormous business benefits to be gained by entering developing markets. In fact, many innovative companies—entrepreneurial outfits and large, established enterprises alike—are already serving the world's poor in ways that generate strong revenues, lead to greater operating efficiencies, and uncover new sources of innovation. For these companies—and those that follow their lead—building businesses aimed at the bottom of the pyramid promises to provide important competitive advantages as the twenty-first century unfolds.

Big companies are not going to solve the economic ills of developing countries by themselves, of course. It will also take targeted financial aid from the developed world and improvements in the governance of the developing nations themselves. But it's clear to us that prosperity can come to the poorest regions only through the direct and sustained involvement of multinational companies. And it's equally clear that the multinationals can enhance their own prosperity in the process.

Untapped Potential

Everyone knows that the world's poor are distressingly plentiful. Fully 65% of the world's population earns less than $2,000 each per year—that's 4 billion people. But despite the vastness of this market, it remains largely untapped by multinational companies. The reluctance to invest is easy to understand. Companies assume that people with such low incomes have little to spend on goods and services and that what they do spend goes to basic needs like food and shelter. They also assume that various barriers to commerce—corruption, illiteracy, inadequate infrastructure, currency fluctuations, bureaucratic red tape—make it impossible to do business profitably in these regions.

But such assumptions reflect a narrow and largely outdated view of the developing world. The fact is, many multinationals already successfully do business in developing countries (although most currently focus on selling to the small upper-middle-class segments of these markets), and their experience shows that the barriers to commerce—although real—are much lower than is typically thought. Moreover, several positive trends in developing countries—from political reform, to a growing openness to investment, to the development of low-cost wireless communication networks—are reducing the barriers further while also providing businesses with greater access to even the poorest city slums and rural areas. Indeed, once the misperceptions are wiped away, the enormous economic potential that lies at the bottom of the pyramid becomes clear.

Take the assumption that the poor have no money. It sounds obvious on the surface, but it's wrong. While individual incomes may be low, the aggregate buying power of poor communities is actually quite large. The average per capita income of villagers in rural Bangladesh, for instance, is less than $200 per year, but as a group they are avid consumers of telecommunications services. Grameen Telecom's village phones, which are owned by a single entrepreneur but used by the entire community, generate an average revenue of roughly $90 a month—and as much as $1,000 a month in some large villages. Customers of these village phones, who pay cash for each use, spend an average of 7% of their income on phone services—a far higher percentage than consumers in traditional markets do.

It's also incorrect to assume that the poor are too concerned with fulfilling their basic needs to "waste" money on nonessential goods. In fact, the poor often do buy "luxury" items. In the Mumbai shantytown of Dharavi, for example, 85% of households own a television set, 75% own a pressure cooker and a mixer, 56% own a gas stove, and 21% have telephones. That's because buying a house in Mumbai, for most people at the bottom of the pyramid, is not a realistic option. Neither is getting access to running water. They accept that reality, and rather than saving for a rainy day, they spend their income on things they can get now that improve the quality of their lives.

Another big misperception about developing markets is that the goods sold there are incredibly cheap and, hence, there's no room for a new competitor to come in and turn a profit. In reality, consumers at the bottom of the pyramid pay much

higher prices for most things than middle-class consumers do, which means that there's a real opportunity for companies, particularly big corporations with economies of scale and efficient supply chains, to capture market share by offering higher quality goods at lower prices while maintaining attractive margins. In fact, throughout the developing world, urban slum dwellers pay, for instance, between four and 100 times as much for drinking water as middle- and upper-class families. Food also costs 20% to 30% more in the poorest communities since there is no access to bulk discount stores. On the service side of the economy, local moneylenders charge interest of 10% to 15% *per day,* with annual rates running as high as 2,000%. Even the lucky small-scale entrepreneurs who get loans from nonprofit microfinance institutions pay between 40% and 70% interest per year—rates that are illegal in most developed countries. (For a closer look at how the prices of goods compare in rich and poor areas, see the exhibit "The High-Cost Economy of the Poor.")

It can also be surprisingly cheap to market and deliver products and services to the world's poor. That's because many of them live in cities that are densely populated today and will be even more so in the years to come. Figures from the UN and the World Resources Institute indicate that by 2015, in Africa, 225 cities will each have populations of more than 1 million; in Latin America, another 225; and in Asia, 903. The population of at least 27 cities will reach or exceed 8 million. Collectively, the 1,300 largest cities will account for some 1.5 billion to 2 billion people, roughly half of whom will be bottom-of-the-pyramid (BOP) consumers now served primarily by informal economies. Companies that operate in these areas will have access to millions of potential new customers, who together have billions of dollars to spend. The poor in Rio de Janeiro, for instance, have a total purchasing power of $1.2 billion ($600 per person). Shantytowns in Johannesburg or Mumbai are no different.

The slums of these cities already have distinct ecosystems, with retail shops, small businesses, schools, clinics, and moneylenders. Although there are few reliable estimates of the value of commercial transactions in slums, business activity appears to be thriving. Dharavi—covering an area of just 435 acres—boasts scores of businesses ranging from leather, textiles, plastic recycling, and surgical sutures to gold jewelry, illicit liquor, detergents, and groceries. The scale of the businesses varies from one-person operations to bigger, well-recognized producers of brand-name products. Dharavi generates an estimated $450 million in manufacturing

The High-Cost Economy of the Poor

When we compare the costs of essentials in Dharavi, a shantytown of more than 1 million people in the heart of Mumbai, India, with those of Warden Road, an upper-class community in a nice Mumbai suburb, a disturbing picture emerges. Clearly, costs could be dramatically reduced if the poor could benefit from the scope, scale, and supply-chain efficiencies of large enterprises, as their middle-class counterparts do. This pattern is common around the world, even in developed countries. For instance, a similar, if less exaggerated, disparity exists between the inner-city poor and the suburban rich in the United States.

Cost	Dharavi	Warden Road	Poverty premium
Credit (annual interest)	600%–1,000%	12%–18%	53X
municipal-grade water (per cubic meter)	$1.12	$0.03	37X
phone call (per minute)	$0.04–$0.05	$0.025	1.8X
diarrhea medication	$20	$2	10X
rice (per kilogram)	$0.28	$0.24	1.2X

revenues, or about $1 million per acre of land. Established shantytowns in São Paulo, Rio, and Mexico City are equally productive. The seeds of a vibrant commercial sector have been sown.

While the rural poor are naturally harder to reach than the urban poor, they also represent a large untapped opportunity for companies. Indeed, 60% of India's GDP is generated in rural areas. The critical barrier to doing business in rural regions is distribution access, not a lack of buying power. But new information technology and communications infrastructures—especially wireless—promise to become an inexpensive way to establish marketing and distribution channels in these communities.

Conventional wisdom says that people in BOP markets cannot use such advanced technologies, but that's just another misconception. Poor rural women in Bangladesh have had no difficulty using GSM cell phones, despite never before using phones of any type. In Kenya, teenagers from slums are being successfully trained as Web page designers. Poor farmers in El Salvador use telecenters to negotiate the sale of their crops over the Internet. And women in Indian coastal villages have in less than a week learned to use PCs to interpret real-time satellite images showing concentrations of schools of fish in the Arabian Sea so they can direct their husbands to the best fishing areas. Clearly, poor communities are ready to adopt new technologies that improve their economic opportunities or their quality of life. The lesson for multinationals: Don't hesitate to deploy advanced technologies at the bottom of the pyramid while, or even before, deploying them in advanced countries.

A final misperception concerns the highly charged issue of exploitation of the poor by MNCs. The informal economies that now serve poor communities are full of inefficiencies and exploitive intermediaries. So if a microfinance institution charges 50% annual interest when the alternative is either 1,000% interest or no loan at all, is that exploiting or helping the poor? If a large financial company such as Citigroup were to use its scale to offer microloans at 20%, is that exploiting or helping the poor? The issue is not just cost but also quality—quality in the range and fairness of financial services, quality of food, quality of water. We argue that when MNCs provide basic goods and services that reduce costs to the poor and help improve their standard of living—while generating an acceptable return on investment—the results benefit everyone.

The Business Case

The business opportunities at the bottom of the pyramid have not gone unnoticed. Over the last five years, we have seen nongovernmental organizations (NGOs), entrepreneurial start-ups, and a handful of forward-thinking multinationals conduct vigorous commercial experiments in poor communities. Their experience is a proof of concept: Businesses can gain three important advantages by serving the poor—a new source of revenue growth, greater efficiency, and access to innovation. Let's look at examples of each.

Top-Line Growth Growth is an important challenge for every company, but today it is especially critical for very large companies, many of which appear to have nearly saturated their existing markets. That's why BOP markets represent such an opportunity for MNCs: They are fundamentally new sources of growth. And because these markets are in the earliest stages of economic development, growth can be extremely rapid.

Latent demand for low-priced, high-quality goods is enormous. Consider the reaction when Hindustan Lever, the Indian subsidiary of Unilever, recently introduced what was for it a new product category—candy—aimed at the bottom of the pyramid. A high-quality confection made with real sugar and fruit, the candy sells for only about a penny a serving. At such a price, it may seem like a marginal business opportunity, but in just six months it became the fastest-growing category in the company's portfolio. Not only is it profitable, but the company estimates it has the potential to generate revenues of $200 million per year in India and comparable markets in five years. Hindustan Lever has had similar successes in India with

low-priced detergent and iodized salt. Beyond generating new sales, the company is establishing its business and its brand in a vast new market.

There is equally strong demand for affordable services. TARAhaat, a start-up focused on rural India, has introduced a range of computer-enabled education services ranging from basic IT training to English proficiency to vocational skills. The products are expected to be the largest single revenue generator for the company and its franchisees over the next several years.[1] Credit and financial services are also in high demand among the poor. Citibank's ATM-based banking experiment in India, called Suvidha, for instance, which requires a minimum deposit of just $25, enlisted 150,000 customers in one year in the city of Bangalore alone.

Small-business services are also popular in BOP markets. Centers run in Uganda by the Women's Information Resource Electronic Service (WIRES) provide female entrepreneurs with information on markets and prices, as well as credit and trade support services, packaged in simple, ready-to-use formats in local languages. The centers are planning to offer other small-business services such as printing, faxing, and copying, along with access to accounting, spreadsheet, and other software. In Bolivia, a start-up has partnered with the Bolivian Association of Ecological Producers Organizations to offer business information and communications services to more than 25,000 small producers of ecoagricultural products.

It's true that some services simply cannot be offered at a low-enough cost to be profitable, at least not with traditional technologies or business models. Most mobile telecommunications providers, for example, cannot yet profitably operate their networks at affordable prices in the developing world. One answer is to find alternative technology. A microfinance organization in Bolivia named PRODEM, for example, uses multilingual smart-card ATMs to substantially reduce its marginal cost per customer. Smart cards store a customer's personal details, account numbers, transaction records, and a fingerprint, allowing cash dispensers to operate without permanent network connections—which is key in remote areas. What's more, the machines offer voice commands in Spanish and several local dialects and are equipped with touch screens so that PRODEM's customer base can be extended to illiterate and semiliterate people.

Another answer is to aggregate demand, making the community—not the individual—the network customer. Gyandoot, a start-up in the Dhar district of central India, where 60% of the population falls below the poverty level, illustrates the benefits of a shared access model. The company has a network of 39 Internet-enabled kiosks that provide local entrepreneurs with Internet and telecommunications access, as well as with governmental, educational, and other services. Each kiosk serves 25 to 30 surrounding villages; the entire network reaches more than 600 villages and over half a million people.

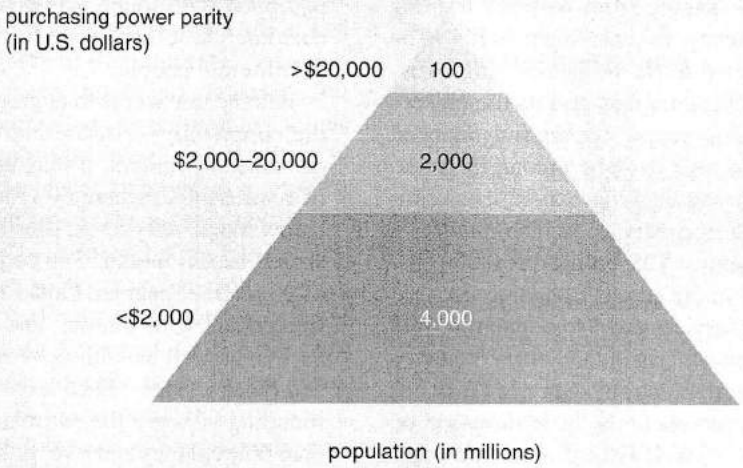
Networks like these can be useful channels for marketing and distributing many kinds of low-cost products and services. Aptech's Computer Education division, for example, has built its own network of 1,000 learning centers in India to market and distribute Vidya, a computer-training course specially designed for BOP consumers and available in seven Indian languages. Pioneer Hi-Bred, a DuPont company, uses Internet kiosks in Latin America to deliver agricultural information and to interact with customers. Farmers can report different crop diseases or weather conditions, receive advice over the wire, and order seeds, fertilizers, and pesticides. This network strategy increases both sales and customer loyalty.

Reduced Costs No less important than top-line growth are cost-saving opportunities. Outsourcing operations to low-cost labor markets has, of course, long been a popular way to contain costs, and it has led to the increasing prominence of China in manufacturing and India in software. Now, thanks to the rapid expansion of high-speed digital networks, companies are realizing even greater savings by

[1] Andrew Lawlor, Caitlin Peterson, and Vivek Sandell, "Catalyzing Rural Development: TARAhaat.com" (World Resources Institute, July 2001).

The World Pyramid

Most companies target consumers at the upper tiers of the economic pyramid, completely overlooking the business potential at its base. But though they may each be earning the equivalent of less than $2,000 a year, the people at the bottom of the pyramid make up a colossal market 4 billion strong—the vast majority of the world's population.



ocating such labor-intensive service functions as all centers, marketing services, and back-office ransaction processing in developing areas. For exmple, the nearly 20 companies that use OrphanIT. om's affiliate-marketing services, provided via s telecenters in India and the Philippines, pay ne-tenth the going rate for similar services in the Inited States or Australia. Venture capitalist Vinod Khosla describes the remote-services opportunity his way: "I suspect that by 2010, we will be talkng about [remote services] as the fastest-growing art of the world economy, with many trillions of ollars of new markets created." Besides keeping osts down, outsourcing jobs to BOP markets can nhance growth, since job creation ultimately inreases local consumers' purchasing power.

But tapping into cheap labor pools is not the nly way MNCs can enhance their efficiency by perating in developing regions. The competitive ecessity of maintaining a low cost structure in hese areas can push companies to discover cretive ways to configure their products, finances, and supply chains to enhance productivity. And these discoveries can often be incorporated back into their existing operations in developed markets.

For instance, companies targeting the BOP market are finding that the shared access model, which disaggregates access from ownership, not only widens their customer base but increases asset productivity as well. Poor people, rather than buying their own computers, Internet connections, cell phones, refrigerators, and even cars, can use such equipment on a pay-per-use basis. Typically, the providers of such services get considerably more revenue per dollar of investment in the underlying assets. One shared Internet line, for example, can serve as many as 50 people, generating more revenue per day than if it were dedicated to a single customer at a flat fee. Shared access creates the opportunity to gain far greater returns from all sorts of infrastructure investments.

In terms of finances, to operate successfully in BOP markets, managers must also rethink their business metrics—specifically, the traditional focus on high gross margins. In developing markets, the

profit margin on individual units will always be low. What really counts is capital efficiency—getting the highest possible returns on capital employed (ROCE). Hindustan Lever, for instance, operates a $2.6 billion business portfolio with zero working capital. The key is constant efforts to reduce capital investments by extensively outsourcing manufacturing, streamlining supply chains, actively managing receivables, and paying close attention to distributors' performance. Very low capital needs, focused distribution and technology investments, and very large volumes at low margins lead to very high ROCE businesses, creating great economic value for shareholders. It's a model that can be equally attractive in developed and developing markets.

Streamlining supply chains often involves replacing assets with information. Consider, for example, the experience of ITC, one of India's largest companies. Its agribusiness division has deployed a total of 970 kiosks serving 600,000 farmers who supply it with soy, coffee, shrimp, and wheat from 5,000 villages spread across India. This kiosk program, called e-Choupal, helps increase the farmers' productivity by disseminating the latest information on weather and best practices in farming, and by supporting other services like soil and water testing, thus facilitating the supply of quality inputs to both the farmers and ITC. The kiosks also serve as an e-procurement system, helping farmers earn higher prices by minimizing transaction costs involved in marketing farm produce. The head of ITC's agribusiness reports that the company's procurement costs have fallen since e-Choupal was implemented. And that's despite paying higher prices to its farmers: The program has enabled the company to eliminate multiple transportation, bagging, and handling steps—from farm to local market, from market to broker, from broker to processor—that did not add value in the chain.

Innovation BOP markets are hotbeds of commercial and technological experimentation. The Swedish wireless company Ericsson, for instance, has developed a small cellular telephone system, called a MiniGSM, that local operators in BOP markets can use to offer cell phone service to a small area at a radically lower cost than conventional equipment entails. Packaged for easy shipment and deployment, it provides stand-alone or networked voice and data communications for up to 5,000 users within a 35-kilometer radius. Capital costs to the operator can be as low as $4 per user, assuming a shared-use model with individual phones operated by local entrepreneurs. The MIT Media Lab, in collaboration with the Indian government, is developing low-cost devices that allow people to use voice commands to communicate—without keyboards—with various Internet sites in multiple languages. These new access devices promise to be far less complex than traditional computers but would perform many of the same basic functions.[2]

As we have seen, connectivity is a big issue for BOP consumers. Companies that can find ways to dramatically lower connection costs, therefore, will have a very strong market position. And that is exactly what the Indian company n-Logue is trying to do. It connects hundreds of franchised village kiosks containing both a computer and a phone with centralized nodes that are, in turn, connected to the national phone network and the Internet. Each node, also a franchise, can serve between 30,000 and 50,000 customers, providing phone, e-mail, Internet services, and relevant local information at affordable prices to villagers in rural India. Capital costs for the n-Logue system are now about $400 per wireless "line" and are projected to decline to $100—at least ten times lower than conventional telecom costs. On a per-customer basis, the cost may amount to as little as $1.[3] This appears to be a powerful model for ending rural isolation and linking untapped rural markets to the global economy.

New wireless technologies are likely to spur further business model innovations and lower costs even more. Ultrawideband, for example, is

[2]Michael Best and Colin M. Maclay, "Community Internet Access in Rural Areas: Solving the Economic Sustainability Puzzle," *The Global Information Technology Report 2001–2002: Readiness for the Networked World*, ed., Geoffrey Kirkman (Oxford University Press, 2002), available on-line at http://www.cid.harvard.edu/cr/gitrr_030202.html.

[3]Joy Howard, Erik Simanis, and Charis Simms, "Sustainable Deployment for Rural Connectivity: The n-Logue Model" (World Resources Institute, July 2001).

currently licensed in the United States only for limited, very low-power applications, in part because it spreads a signal across already-crowded portions of the broadcast spectrum. In many developing countries, however, the spectrum is less congested. In fact, the U.S.-based Dandin Group is already building an ultrawideband communications system for the Kingdom of Tonga, whose population of about 100,000 is spread over dozens of islands, making it a test bed for a next-generation technology that could transform the economics of Internet access.

E-commerce systems that run over the phone or the Internet are enormously important in BOP markets because they eliminate the need for layers of intermediaries. Consider how the U.S. start-up Voxiva has changed the way information is shared and business is transacted in Peru. The company partners with Telefónica, the dominant local carrier, to offer automated business applications over the phone. The inexpensive services include voice mail, data entry, and order placement; customers can check account balances, monitor delivery status, and access prerecorded information directories. According to the Boston Consulting Group, the Peruvian Ministry of Health uses Voxiva to disseminate information, take pharmaceutical orders, and link health care workers spread across 6,000 offices and clinics. Microfinance institutions use Voxiva to process loan applications and communicate with borrowers. Voxiva offers Web-based services, too, but far more of its potential customers in Latin America have access to a phone.

E-commerce companies are not the only ones turning the limitations of BOP markets to strategic advantage. A lack of dependable electric power stimulated the UK-based start-up Freeplay Group to introduce hand-cranked radios in South Africa that subsequently became popular with hikers in the United States. Similar breakthroughs are being pioneered in the use of solar-powered devices such as battery chargers and water pumps. In China, where pesticide costs have often limited the use of modern agricultural techniques, there are now 13,000 small farmers—more than in the rest of the world combined—growing cotton that has been genetically engineered to be pest resistant.

Strategies for Serving BOP Markets

Certainly, succeeding in BOP markets requires multinationals to think creatively. The biggest change, though, has to come in the attitudes and practices of executives. Unless CEOs and other business leaders confront their own preconceptions, companies are unlikely to master the challenges of BOP markets. The traditional workforce is so rigidly conditioned to operate in higher-margin markets that, without formal training, it is unlikely to see the vast potential of the BOP market. The most pressing need, then, is education. Perhaps MNCs should create the equivalent of the Peace Corps: Having young managers spend a couple of formative years in BOP markets would open their eyes to the promise and the realities of doing business there.

To date, few multinationals have developed a cadre of people who are comfortable with these markets. Hindustan Lever is one of the exceptions. The company expects executive recruits to spend at least eight weeks in the villages of India to get a gut-level experience of Indian BOP markets. The new executives must become involved in some community project—building a road, cleaning up a water catchment area, teaching in a school, improving a health clinic. The goal is to engage with the local population. To buttress this effort, Hindustan Lever is initiating a massive program for managers at all levels—from the CEO down—to reconnect with their poorest customers. They'll talk with the poor in both rural and urban areas, visit the shops these customers frequent, and ask them about their experience with the company's products and those of its competitors.

In addition to expanding managers' understanding of BOP markets, companies will need to make structural changes. To capitalize on the innovation potential of these markets, for example, they might set up R&D units in developing countries that are specifically focused on local opportunities. When Hewlett-Packard launched its e-Inclusion division, which concentrates on rural markets, it established a branch of its famed

HP Labs in India charged with developing products and services explicitly for this market. Hindustan Lever maintains a significant R&D effort in India, as well.

Companies might also create venture groups and internal investment funds aimed at seeding entrepreneurial efforts in BOP markets. Such investments reap direct benefits in terms of business experience and market development. They can also play an indirect but vital role in growing the overall BOP market in sectors that will ultimately benefit the multinational. At least one major U.S. corporation is planning to launch such a fund, and the G8's Digital Opportunity Task Force is proposing a similar one focused on digital ventures.

MNCs should also consider creating a business development task force aimed at these markets. Assembling a diverse group of people from across the corporation and empowering it to function as a skunk works team that ignores conventional dogma will likely lead to greater innovation. Companies that have tried this approach have been surprised by the amount of interest such a task force generates. Many employees want to work on projects that have the potential to make a real difference in improving the lives of the poor. When Hewlett-Packard announced its e-Inclusion division, for example, it was overwhelmed by far more volunteers than it could accommodate.

Making internal changes is important, but so is reaching out to external partners. Joining with businesses that are already established in these markets can be an effective entry strategy, since these companies will naturally understand the market dynamics better. In addition to limiting the risks for each player, partnerships also maximize the existing infrastructure—both physical and social. MNCs seeking partners should look beyond businesses to NGOs and community groups. They are key sources of knowledge about customers' behavior, and they often experiment the most with new services and new delivery models. In fact, of the social enterprises experimenting with creative uses of digital technology that the Digital Dividend Project Clearinghouse tracked, nearly 80% are NGOs. In Namibia, for instance, an organization called SchoolNet is providing low-cost, alternative technology solutions—such as solar power and wireless approaches—to schools and community-based groups throughout the country. SchoolNet is currently linking as many as 35 new schools every month.

Entrepreneurs also will be critical partners. According to an analysis by McKinsey & Company, the rapid growth of cable TV in India—there are 50 million connections a decade after introduction—is largely due to small entrepreneurs. These individuals have been building the last mile of the network, typically by putting a satellite dish on their own houses and laying cable to connect their neighbors. A note of caution, however. Entrepreneurs in BOP markets lack access to the advice, technical help, seed funding, and business support services available in the industrial world. So MNCs may need to take on mentoring roles or partner with local business development organizations that can help entrepreneurs create investment and partnering opportunities.

It's worth noting that, contrary to popular opinion, women play a significant role in the economic development of these regions. MNCs, therefore, should pay particular attention to women entrepreneurs. Women are also likely to play the most critical role in product acceptance not only because of their childcare and household management activities but also because of the social capital that they have built up in their communities. Listening to and educating such customers is essential for success.

Regardless of the opportunities, many companies will consider the bottom of the pyramid to be too risky. We've shown how partnerships can limit risk; another option is to enter into consortia. Imagine sharing the costs of building a rural network with the communications company that would operate it, a consumer goods company seeking channels to expand its sales, and a bank that is financing the construction and wants to make loans to and collect deposits from rural customers.

Sharing Intelligence

What creative new approaches to serving the bottom-of-the-pyramid markets have digital technologies made possible? Which sectors or countries show the most economic activity or the fastest growth? What new business models show promise? What kinds of partnerships—for funding, distribution, public relations—have been most successful?

The Digital Dividend Project Clearinghouse (digitaldividend.org) helps answer those types of questions. The Web site tracks the activities of organizations that use digital tools to provide connectivity and deliver services to underserved populations in developing countries. Currently, it contains information on 700 active projects around the world. Maintained under the auspices of the nonprofit World Resources Institute, the site lets participants in different projects share experiences and swap knowledge with one another. Moreover, the site provides data for trend analyses and other specialized studies that facilitate market analyses, local partnerships, and rapid, low-cost learning.

Investing where powerful synergies exist will also mitigate risk. The Global Digital Opportunity Initiative, a partnership of the Markle Foundation and the UN Development Programme, will help a small number of countries implement a strategy to harness the power of information and communications technologies to increase development. The countries will be chosen in part based on their interest and their willingness to make supportive regulatory and market reforms. To concentrate resources and create reinforcing effects, the initiative will encourage international aid agencies and global companies to assist with implernentation.

All of the strategies we've outlined here will be of little use, however, unless the external barriers we've touched on—poor infrastructure, inadequate connectivity, corrupt intermediaries, and the like—are removed. Here's where technology holds the most promise. Information and communications technologies can grant access to otherwise isolated communities, provide marketing and distribution channels, bypass intermediaries, drive down transaction costs, and help aggregate demand and buying power. Smart cards and other emerging technologies are inexpensive ways to give poor customers a secure identity, a transaction or credit history, and even a virtual address—prerequisites for interacting with the formal economy. That's why high-tech companies aren't the only ones that should be interested in closing the global digital divide; encouraging the spread of low-cost digital networks at the bottom of the pyramid is a priority for virtually all companies that want to enter and engage with these markets. Improved connectivity is an important catalyst for more effective markets, which are critical to boosting income levels and accelerating economic growth.

Moreover, global companies stand to gain from the effects of network expansion in these markets. According to Metcalfe's Law, the usefulness of a network equals the square of the number of users. By the same logic, the value and vigor of the economic activity that will be generated when hundreds of thousands of previously isolated rural communities can buy and sell from one another and from urban markets will increase dramatically—to the benefit of all participants.

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Since BOP markets require significant rethinking of managerial practices, it is legitimate for managers to ask: Is it worth the effort?

We think the answer is yes. For one thing, big corporations should solve big problems—and what is a more pressing concern than alleviating the poverty that 4 billion people are currently mired in? It is hard to argue that the wealth of technology and

talent within leading multinationals is better allocated to producing incremental variations of existing products than to addressing the real needs—and real opportunities—at the bottom of the pyramid. Moreover, through competition, multinationals are likely to bring to BOP markets a level of accountability for performance and resources that neither international development agencies nor national governments have demonstrated during the last 50 years. Participation by MNCs could set a new standard, as well as a new market-driven paradigm, for addressing poverty.

But ethical concerns aside, we've shown that the potential for expanding the bottom of the market is just too great to ignore. Big companies need to focus on big market opportunities if they want to generate real growth. It is simply good business strategy to be involved in large, untapped markets that offer new customers, cost-saving opportunities, and access to radical innovation. The business opportunities at the bottom of the pyramid are real, and they are open to any MNC willing to engage and learn.