



# Shaping the New Rules of Competition: UN Global Compact Participant Mirror

July 2007



**The rewards of  
success can be  
large and lasting**

# **Shaping the New Rules of Competition:** UN Global Compact Participant Mirror

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## Overview of Research

This paper is based primarily on a survey of CEOs of companies participating in the UN Global Compact, which was followed by in-depth interviews with CEOs and top executives of some of these companies.

The 391 survey respondents represent 230 companies with their headquarters in Europe, 73 in the Americas (including 56 in Latin America, 14 in the US, and 3 in Canada), 47 in Asia, 25 in Africa, 9 in the Middle East and 7 in Australasia. These companies vary widely in size: 280 generated less than \$1 billion in annual revenues, 59 between \$1 billion and \$9.9 billion, and 52 \$10 billion or more. The organizations include 275 private and 79 public companies, 28 state-owned firms, and 9 nonprofits. Their industries include aerospace/aviation, agriculture, auto, chemicals, construction, consumer packaged goods, consumer services, education, mining and extraction, finance, healthcare, industrial manufacturing, insurance, paper & forestry, pharmaceutical, professional services, public services, retail, technology, telecom, textile & apparel, tourism, and transport.

We conducted in-depth interviews with CEOs and top executives of 38 organizations, of which 31 were companies (24 multinational and 7 national) and 7 were civil society organizations. Of the 38 companies and civil society organizations, 20 were headquartered in Europe, 12 in the Americas (6 in the United States and 6 in Latin America) and 6 in the rest of the world (2 in Asia, 2 in the Middle East, 1 in Africa and 1 in Australasia).

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**There is growing recognition that the marketplace and private enterprise can and must help find solutions to global problems**

# Introduction



Until a generation ago, the chief executives of many companies believed they were doing their jobs if they satisfied shareholders and complied with the law. Since then, employees, consumers, local communities and other stakeholders have found ways to make their voices heard in the boardroom. They demand much more from companies than financial success—and more than the law may require.

Today, the CEOs of most leading firms recognize that they are part of a vast social contract, and that the terms of that contract are becoming tougher and more complex with each passing year. According to our research, conducted earlier this year with approximately 400 CEOs and top executives of companies participating in the United Nations Global Compact (UNGC),<sup>1</sup> more than 9 out of 10 corporate leaders are doing more than they did 5 years ago to incorporate environmental, social, and political issues into their firms' core strategies.<sup>2</sup>

Many executives see the new standards and demands as burdens. But our research shows that some visionary CEOs are recognizing them as opportunities to apply their creativity and resources to gain competitive advantage, and help address some of the world's biggest challenges. As governments around the world wrestle to address issues that cross borders, there is growing recognition that the marketplace and private enterprises that operate on a global scale

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1 The United Nations Global Compact is an initiative established in 2000 to encourage businesses worldwide to adopt sustainable and socially responsible policies, and to report on them. Under the Compact, companies are brought together with UN agencies, labor groups and civil society.

2 McKinsey UN Global Compact CEO Participant Survey 2007.

can and must help find solutions to global problems. Many experts believe, for example, that given the right price signals, the market is better equipped to address climate change than any central planning or state enterprise model.

We are therefore witnessing the dawn of a new era in corporate innovation and experimentation, when new partnerships and standards will emerge, when new, more transparent measures will better reflect the full costs of doing business, and when greater private participation in the delivery of public goods and services will change companies' roles in society.

Failures will be costly to communities, corporate reputations and bottom lines. But the rewards of success can be large and lasting. Companies that can meet difficult environmental, social and governance (ESG) challenges will be positioned to succeed in the years ahead, especially in markets that require new business models and untraditional partnerships.

Market-based globalization is no panacea for the world's ills, but we believe progress is more likely with this system than with any other. In our research, CEOs of participant companies said that the Global Compact can help accelerate their learning process in addressing ESG issues, as both a framework and convener, helping them turn enlightened self-interest into a practical reality.

In this paper, we use our survey and interview data, and other research, to explain why businesses must confront ESG challenges. We describe the issues companies are facing internally and externally, and the barriers to integrated solutions. In the final chapter, we present new models of collaboration and competition, some of which are helping companies succeed today.

# Chapter One:

## Increased pressures are creating a new game



Today's CEOs are under pressure to address pervasive, and at times explosive, environmental, social and governance issues. Companies once held accountable only for the direct, contractually specified or regulated consequences of their actions now find themselves responsible for issues as disparate as environmental sustainability, the spread of HIV/AIDS, and child labor in sub-Saharan Africa. Consumers and employees are joining an ever-expanding set of sophisticated stakeholders with fresh demands and increasing power to threaten a company's commercial viability.

In the words of a Latin American extractives CEO, "Society's expectations of our company and business in general have increased significantly in the last 5 years, particularly around environmental issues and broader social and economic development."<sup>3</sup> Many of the executives we interviewed echoed his opinion, including those in consumer packaged goods, financial services, pharmaceutical, and other industries. In our survey of 391 CEOs of companies participating in the UN Global Compact, an average of 95 percent agreed that society has greater expectations for business to take on public responsibilities than it had 5 years ago.<sup>4</sup> Regardless of company size or geography, more than 90 percent of CEOs believe these expectations are higher today, and many predict that they will increase significantly in the next 5 years (Exhibit 1).

Even while society's expectations are rising, its trust in multinational corporations is hitting new lows. In a 2006 McKinsey global survey of more than 4,000 consumers, only 33 percent of Europeans and 40 percent of Americans said

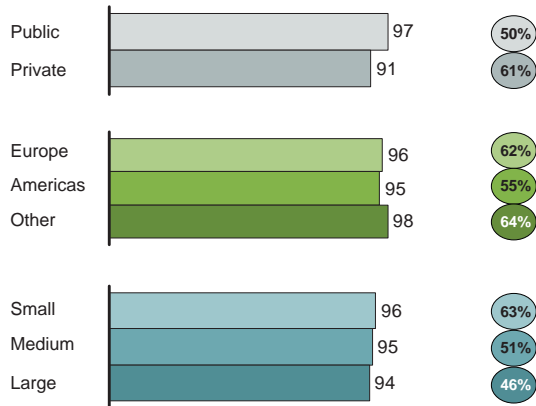
**Society has greater expectations for business to take on public responsibilities than it had 5 years ago**

3 All quotes unless otherwise noted are from McKinsey interviews, conducted February to April 2007, with CEOs or other executive leaders of companies and civil society organizations participating in the United Nations Global Compact.

4 McKinsey UN Global Compact CEO Participant Survey 2007.

**Exhibit 1: Societal expectations**

Percent of participants that believe society has higher expectations for business to take on public responsibilities than 5 years ago... ..and that this will change over the next 5 years



Source: Feb 2007 McKinsey survey of 391 UN Global Compact participant CEOs

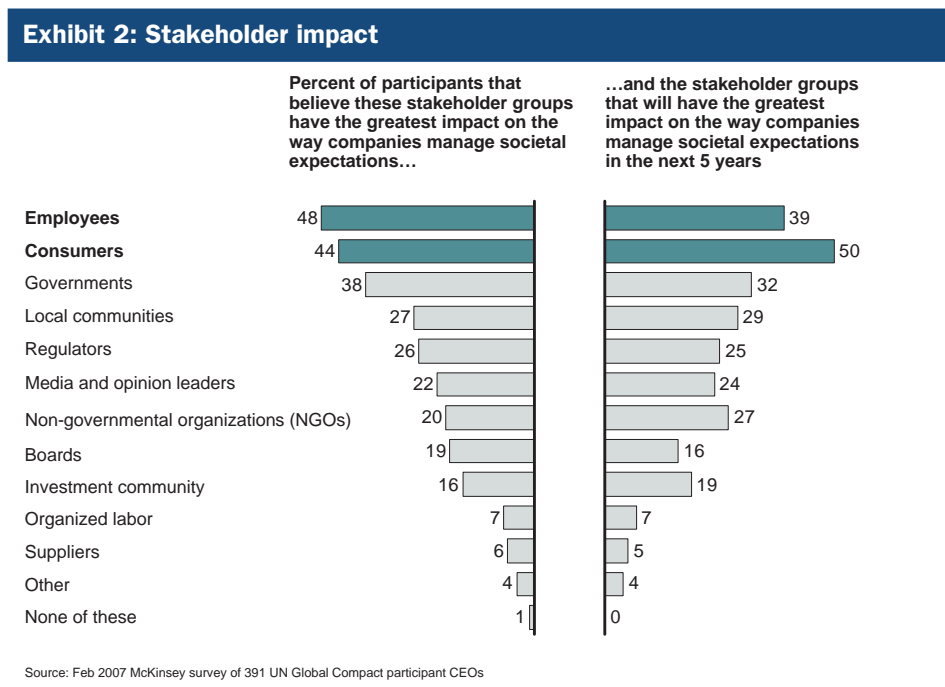
they believed large, global companies act in the best interest of society at least some of the time.<sup>5</sup> Yet winning or retaining people’s trust is key to the success of any business. As the CEO of a large financial institution put it, “The predominant concern for us is the erosion of trust, [which] is impacting our employee and customer franchises.”

To create long-term shareholder value, companies realize that they must maintain or boost their legitimacy in society even as the bar gets higher. While this prospect may seem daunting, our interviewees recognize the importance of the effort. A retail company CEO, for example, explained that “if companies do not respond to this trend, they will miss the boat with their institutional image and reputation for corporate responsibility.” But rather than lamenting their new responsibilities, executives are increasingly seeing them as an opportunity. As businesses enter new territories where guidelines have yet to be set, executives are developing their own rules of governance to create a new competitive edge. As one CEO of a packaged goods firm noted, “Companies have far more control over their destiny than in the past, as the lines between government and business are becoming more and more blurred all around the world.” Based on our research, we believe that companies who take the ESG agenda seriously will gain a lead in the competition for legitimacy.

5 With NGOs receiving more than double this vote of confidence (82 percent of European respondents, and 84 percent of US respondents trusted them to act in the best interest of society), it is clear that business has some leaps to make in terms of legitimacy.

## CONSUMERS AND EMPLOYEES ARE GAINING INFLUENCE

Many of the CEOs we spoke with emphasized that not fulfilling ESG obligations would lead to declining market shares and loss of talent. In our survey, CEOs ranked employees as the stakeholder group that has the greatest impact on the way a firm manages societal expectations, with consumers a close second.<sup>6</sup> Over the next 5 years the respondents, particularly those from large corporations, expect consumer influence to change substantially, with employee clout dropping to second place (Exhibit 2). What's more, both of these groups are joining NGOs and activists in making increasing demands on companies.



The ethical consumer has clearly emerged and is on the rise. Responsiveness to ESG issues, noted the CEO of an industrial materials company, is “increasingly a question for customers; they want to be certain we have our house in order. At this point it’s a differentiating factor.” The food industry provides one example of consumers voting with their wallets. In the United States, for example, sales of organic products have grown by 15 to 21 percent a year compared with 2 to 3 percent for conventional products,<sup>7</sup> despite a significant price premium. Business leaders expect this trend of the ethical consumer to grow. As the vice president of a retail company put it, “The future trend is for a more hysteric consumer who wants more of everything, including socially responsible products.”

**The ethical consumer has clearly emerged and is on the rise**

6 McKinsey UN Global Compact CEO Participant Survey 2007.

7 Based on annual growth rates 1997–2005, Organic Trade Association’s 2006 Manufacturer’s survey.

Meanwhile, in the increasingly intense competition for scarce workforce skills, a socially responsible company has an edge both in recruiting and retaining essential talent. “It is important,” said the CEO of a retail company, “for our employees to know and to see that they are working for a company where these things are held to be important.” This trend is likely to intensify; according to one interviewee from a financial institution: “Baby boomers were careerists whereas the younger generations are less tolerant of bureaucracy and prepared to reject the institution if it doesn’t fit with their lifestyle and values.” The same financial institution surveyed employees and identified demand for a sabbatical option to do nonprofit or volunteer work. Some companies are realizing that if they don’t heed these requests, they may find their employees on permanent sabbatical.

### **GLOBALIZATION WILL CONTINUE TO INCREASE PRESSURES**

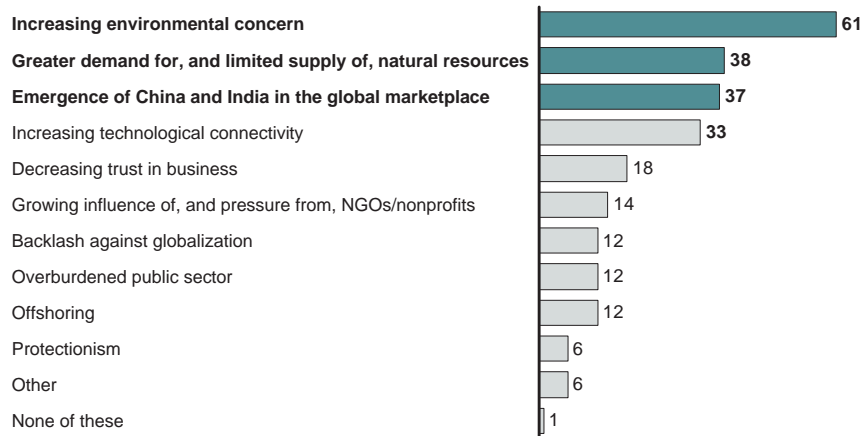
**China and India  
are becoming  
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There is little question that globalization is here to stay, and that it is evolving in a way that increases pressures to address ESG issues. Earlier phases of globalization saw Western economies seeking alternative sources of supply – be they relatively low cost goods and services or natural resources. The next phase will create further global integration, with China and India becoming drivers of demand as well as providers of low-cost goods and services. There will be greater service integration across national boundaries (making intangibles even more valuable), and more systematic factor price equalization, especially in the high-end talent markets. All this suggests that, if anything, ESG expectations on global companies will rise.

The Chinese and Indian interpretation of these norms will have a more pervasive influence, and companies will need to find ways to demonstrate their “local” loyalties in parallel with their efforts to build globally integrated value systems. The responses to our survey reinforce this analysis. CEOs selected developments linked to accelerated global patterns of growth as the three most important trends that are influencing society’s expectations on businesses. Increasing environmental concern was seen as the most important trend, followed by the limited supply of natural resources, and the emergence of China and India in the global marketplace, in third place (Exhibit 3).

### Exhibit 3: Trends influencing society's expectations on business

Percent of respondents that believe the following trends are most important in influencing society's expectations on business



Source: Feb 2007 McKinsey survey of 391 UN Global Compact participant CEOs



**Top issues  
demand both  
systemic change  
and sustained  
engagement by  
business**

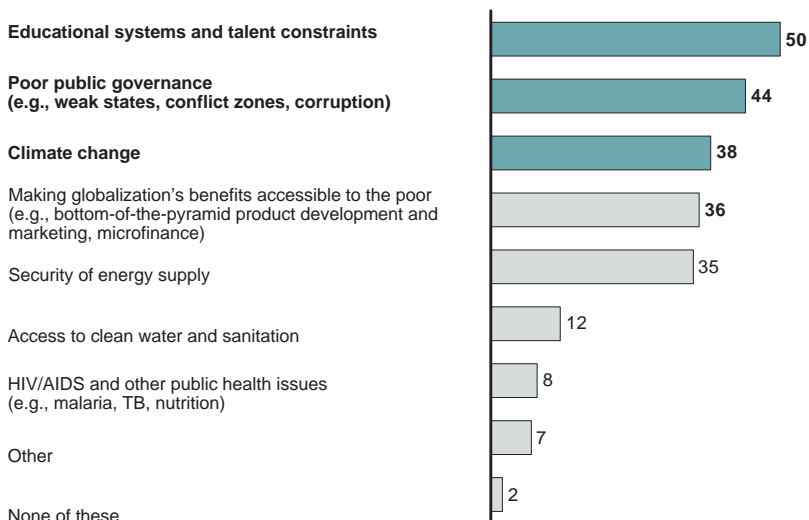
## Chapter Two: External challenges are daunting



The issues that companies increasingly have no choice but to confront are becoming so complex that they can seem intractable. Top issues to address, such as climate change, education and talent constraints, and poor public governance, demand both systemic change and sustained engagement by business (Exhibit 4). In what could be a profound mindset shift, many CEOs recognize the underlying tension between business models wedded to increasing patterns of consumption, and the reality of limited natural resources.

### Exhibit 4: Global environmental, social and political issues

Percent of respondents that believe the following global environmental, social and political issues are the most critical to address for the future success of their business



Source: Feb 2007 McKinsey survey of 391 UN Global Compact participant CEOs

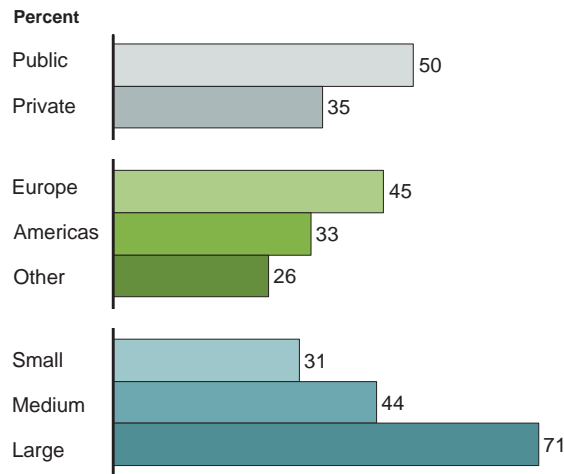
### ENVIRONMENTAL CHALLENGES

The robust economic growth that has transformed many developing countries has also exacerbated the prospect of shortages of important natural resources,

particularly energy and water, as well as increasing carbon dioxide emissions that contribute to global climate change. A recent *Energy Outlook* report states that global energy consumption is projected to increase by 57 percent from 2004 to 2030, with total energy demand in the non-OECD countries increasing by 95 percent, compared to an increase of 24 percent in the OECD countries.<sup>8</sup>

Reducing current levels of global emissions of greenhouse gases will become increasingly difficult as demand for energy grows in developing economies, which traditionally have been less energy efficient than developed economies. Indeed, concern about global climate change has spread to the executive suites of most every corporation around the world, not only the largest ones (Exhibit 5). As the CEO of a packaged goods company said, “If you’d talked to any CEO about what their carbon footprint was one year ago, you’d have been met with a fairly blank stare. Now they’d be able to give you a pretty good answer.”

**Exhibit 5: Respondents that believe climate change is the most critical ESG issue to address for the future success of their business**



Source: Feb 2007 McKinsey survey of 391 UN Global Compact participant CEOs

The outlook for fresh water supplies seems equally bleak. Total fresh water availability per capita fell by more than 50 percent in the second half of the 20th century.<sup>9</sup> Rapidly industrializing countries like China and India are beginning to face the prospect of constrained economic growth because of a lack of water resources. India, for example, has some 20 percent of the world’s population but only around 4 percent of its fresh water resources.<sup>10</sup> As the CEO of a large

8 Energy Information Administration “International Energy Outlook 2007”.

9 OECD Environmental Outlook Database 2006.

10 *The Financial Express* (India), May 6, 2007.

consumer packaged goods company told us, “Water is the biggest issue for our company right now – the ability to do business in water-stressed areas is critical to our growth.”

## **SOCIAL CHALLENGES**

If natural resource constraints appear unwieldy, social issues are no less troubling. Companies face a plethora of issues with attracting and maintaining their labor force, be it in ensuring sound labor practices, absorbing increasing healthcare costs, or sourcing skilled employees in areas with limited educational systems. With ever-expanding globalization, businesses are also finding themselves responsible for meeting the needs of the world’s poor.

Workers’ rights in the developing world leave much to be desired. One of the most pressing problems is child labor. In the Asia-Pacific region almost 1 child out of 5 between the ages of 5 and 14 is in the workforce. In Sub-Saharan Africa that figure is closer to 3 out of 10.<sup>11</sup> As the CEO of a textile distributor explained, the pervasiveness of the problem makes individual solutions insufficient: “Child labor is a problem because even if you raise your standards, it may not stop the child from walking across the street to the next factory.”

**In the Asia-Pacific region almost 1 child out of 5 between the ages of 5 and 14 is in the workforce**

Healthcare for workers is also becoming a pressing issue for the international business community because some governments are simply not up to the task of keeping their populations healthy. The World Health Organization estimates that at least 1.3 billion people worldwide lack access to basic healthcare, and that infectious diseases and complications of pregnancy cause at least 10 million deaths a year.<sup>12</sup> The global HIV/AIDS epidemic will only make the situation worse. A CEO of a large company explains that “companies will also have to think about the health of their employees in doing business in places like South Africa in terms of HIV.” In our survey, HIV/AIDS and other public health issues were three times as important for CEOs in countries outside of Europe and the Americas (18 percent rated it a top 3 issue).<sup>13</sup> From a financial point of view, the problem is no less dire in the developed world, as healthcare costs for workers and retirees continue to grow. A 2004 survey of US corporations found that 88 percent of them ranked controlling the cost of health insurance as the most critical challenge they face as employers.<sup>14</sup>

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11 UNICEF website 2007.

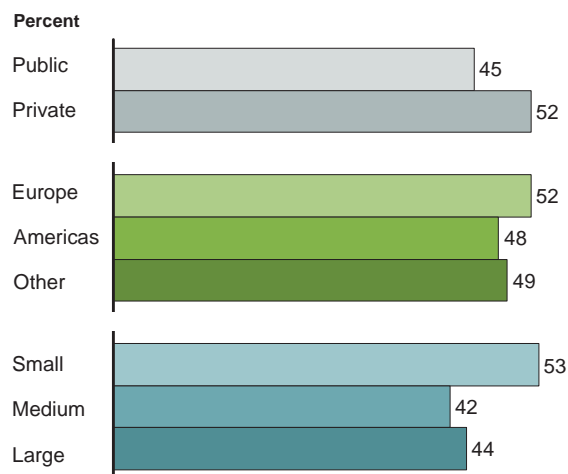
12 WHO website 2007.

13 McKinsey UN Global Compact CEO Participant Survey 2007.

14 The Kaiser Family Foundation, Health Insurance Survey, October 2004 .

Rapid economic growth has made attracting and retaining qualified employees a quickly burgeoning issue. In our survey, limitations of local educational systems and resulting talent constraints was regarded as one of the top 3 issues most critical to address, and of chief concern for small companies (Exhibit 6). The problem is particularly acute in India and China. A McKinsey Global Institute study in 2005 concluded that only 25 percent of India’s young professionals (with 7 years or less work experience) and 15 percent of its finance and accounting graduates have the skills to work for an international company.<sup>15</sup>

**Exhibit 6: Respondents that believe educational systems and talent constraints are the most critical ESG issues to address for the future success of their business**



Source: Feb 2007 McKinsey survey of 391 UN Global Compact participant CEOs

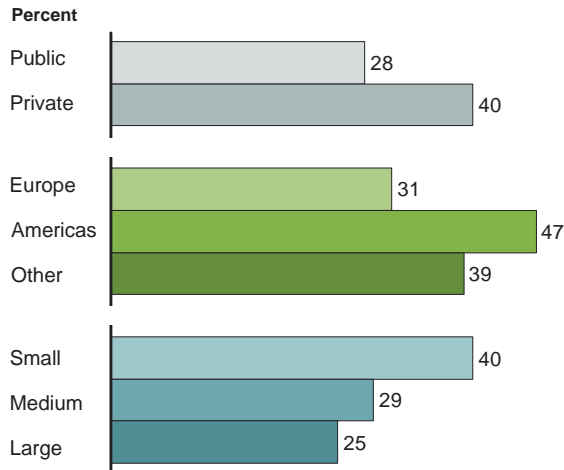
Finally, many CEOs we surveyed are interested in ensuring that the benefits of globalization extend to the world’s poor. In particular, the CEOs of small and private companies believed this issue to be of most importance (Exhibit 7).

**GOVERNANCE CHALLENGES**

Most companies encounter governance challenges, either at the global or local level. The lack of global governance is a challenge that is more evident as globalization continues. As one CEO described it, “Globalization has separated

15 McKinsey Global Institute report “The Emerging Global Labor Market: Part II—The Supply of Offshore Talent in Services” Diana Farrell, Martha Laboissière, Jaeson Rosenfeld, Sascha Stürze, Fusayo Umezawa; 2005.

**Exhibit 7: Respondents that believe making globalization's benefits accessible to the poor is the most critical ESG issue to address for the future success of their business**



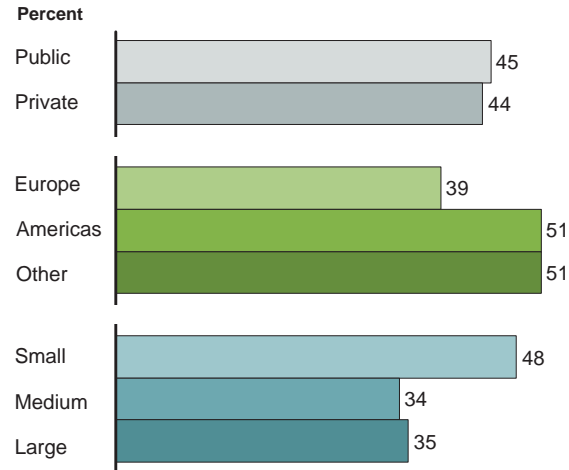
Source: Feb 2007 McKinsey survey of 391 UN Global Compact participant CEOs

economics and politics, leaving a gap between national-level laws and regulations and nothing at the global level. We need to strengthen global frameworks for issues like the environment and labor.”

At the local level, companies have discovered another governance challenge when operating in countries with underdeveloped legal and judicial systems. Poor public governance (for instance, in weak states in conflict zones) surfaced as the second most important issue to address for future business success, and was most critical for small companies and those outside of Europe (Exhibit 8). The impact of corruption on the bottom line has created a different kind of pressure on some companies. As one interviewee explained, “our business model is not working in Russia because of the facilitation payments and we have lost profits.”

The overall impact of the growing importance of ESG issues is that more than 90 percent of the CEOs in our survey said they are incorporating ESG issues into core strategy more than they did 5 years ago (Exhibit 9).

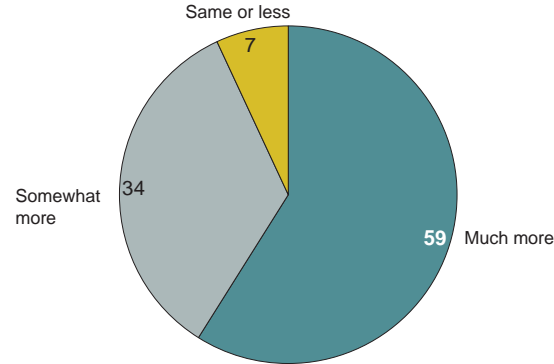
**Exhibit 8: Respondents that believe poor public governance is the most critical ESG issue to address for the future success of their business**



Source: Feb 2007 McKinsey survey of 391 UN Global Compact participant CEOs

**Exhibit 9: Incorporating ESG issues into strategy**

Percent of respondents that are incorporating environmental, social and governance issues into their firm's core strategy more compared to 5 years ago



Source: Feb 2007 McKinsey survey of 391 UN Global Compact participant CEOs

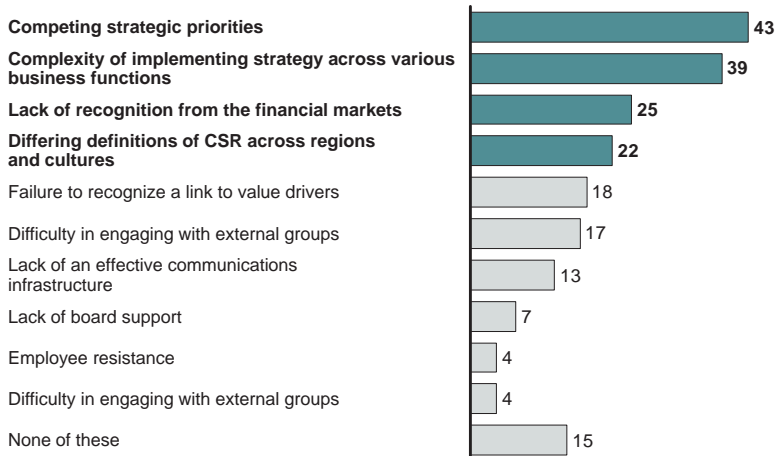
# Chapter Three: Internal challenges are creating barriers



Even the most socially aware and engaged companies run into internal challenges with ESG issues for several reasons. There are no established global guidelines or strong investor incentives for ESG work, it is incredibly complex, and it is typically not a core skill. CEOs explain that they face a series of tensions in implementing an integrated and strategic company-wide approach (Exhibit 10).

## Exhibit 10: Barriers to CEO engagement

Percent of respondents that believe barriers keep them, as a CEO, from implementing an integrated and strategic company-wide approach to ESG issues



Source: Feb 2007 McKinsey survey of 391 UN Global Compact participant CEOs

### COMPETING STRATEGIC PRIORITIES

While the majority of CEOs responding to our survey believe that there is a strategic business case for proactively managing ESG issues, they face a first barrier of competing strategic priorities such as their shareholders' demands for solid short-term performance. This conflict is exacerbated by the longer-term nature of ESG investments, the absence of universal ESG reporting metrics, and

**Less than one-fifth of CEOs are convinced that financial markets take ESG issues into account**

the conflicting interests of a wide range of individual stakeholders. Addressing most ESG issues involves significant upfront investments for long-term impact. With no clear and consistent investor measures of ESG that relate or correlate with investor returns, less than one-fifth of the CEOs are convinced that financial markets take ESG issues into account when valuing a company.<sup>16</sup> While some common standards have been developed (for example, through the Global Reporting Initiative), one CEO of a financial institution noted they have “yet to become benchmarks to look up in the *Wall Street Journal*, where we can see alongside stock price that ESG impact rating went from 2 to 12 and that somehow becomes a factor in how we value the company.” So while companies are willing to invest in ESG programs during economic upturns, there is a persistent sense that they will be at risk when the economy or a company’s fortunes turn down.

Beyond managing to keep shareholders and the financial markets happy when attempting to set appropriate strategic priorities, each industry faces its own peculiar set of tradeoffs involving various non-financial stakeholders. For example, the electric power sector must take into account demands for energy security, an undamaged environment, and low prices. The public demands lower rates but wants power companies to invest in sufficient capacity to insure against costly blackouts as well as in new technologies to protect the environment. The CEO of an energy company explained, “We have to accept society’s contradictions – people want electricity, but are concerned with alternative [energy] sources.”

#### **LACK OF NORMS TO LEVEL THE GLOBAL PLAYING FIELD**

**“The world is not flat, but quite hilly”**

Another barrier is that definitions of corporate social responsibility and other norms for addressing ESG issues differ across regions. There are no consistent industry regulations or, in their absence, norms that effectively level the ESG playing field in different local contexts. One CEO we interviewed said “the world is not flat, but quite hilly” to illustrate the complicated reality of globalization. With no global set of operating standards, companies attempting to impose standards on their world-wide operations often find local norms and regulations in conflict with what seem to be worthy goals. The CEO of a European extractive company explained how when operating a mine in Africa, for example, the company had to reconcile its own safety standards with a higher risk environment. The consequence is that there are still significant free-rider problems and a risk for those companies that wish to deploy higher “international norms” (for example, with respect to child labor) that they will lose out to less scrupulous competitors

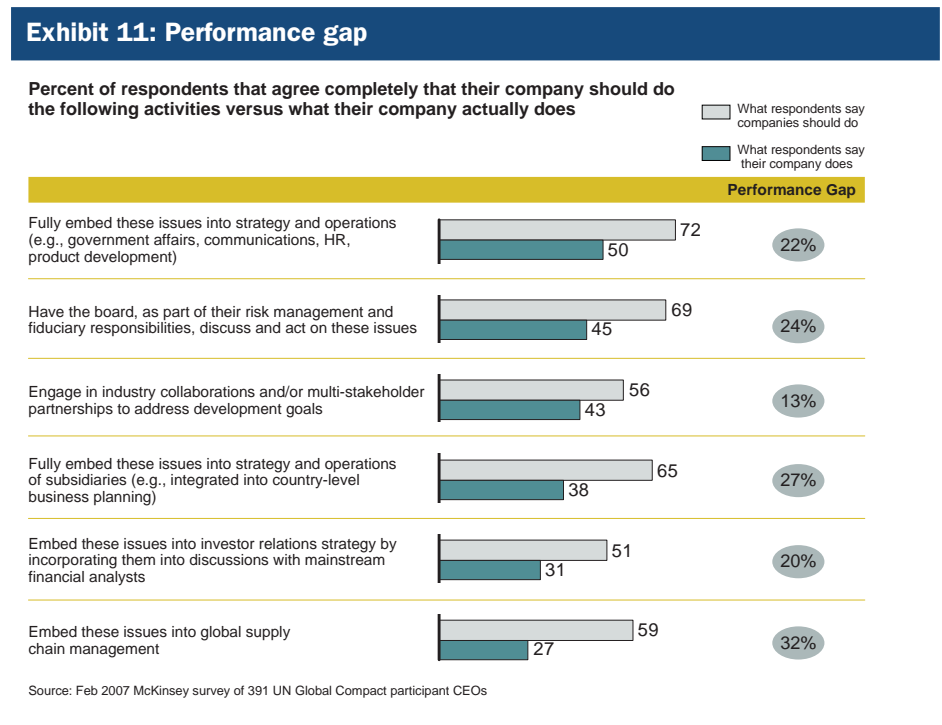
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<sup>16</sup> McKinsey UN Global Compact CEO Participant Survey 2007.

especially in commoditized, unbranded product categories. Despite the progress made by organizations to provide frameworks for social issues, it is clear that there are still strong “race to the bottom” pressures which could easily get exacerbated in the next economic downturn.

## PRACTICAL IMPLEMENTATION CHALLENGES

The complexity of implementing an ESG strategy is another important barrier. There are material practical challenges in translating good intentions into good deeds. While 72 percent of the CEOs we surveyed said that a corporate stance on ESG issues should be fully embedded into the strategy and operations, only 50 percent think their firms actually do so (Exhibit 11).



Finding talent to implement global strategies is a major challenge. In 2005, *The McKinsey Quarterly* surveyed CEOs, 31 percent of whom said that finding talent would be their biggest challenge in the next 5 years, a number that jumped to 40 percent for China and 38 percent for India.<sup>17</sup> The result is often a less than optimal mix of expatriate and local managers, which further complicates the implementation of ESG policies.

17 *The McKinsey Quarterly* & Strategy Practice Global Trends Survey, February 2005.

Supply chain practices are even more difficult to mandate, with many suppliers openly questioning the need to invest in equipment or more humane management practices. First, as the CEO of an industrial manufacturing company said, “there are questions about how far up and how far down supply chain responsibility goes.” Then, if a company does decide to implement a global code of conduct, “there is often tension with local companies that don’t see why they need to have such high standards – putting in a new water treatment plant seems like an unnecessary cost,” as the CEO of a consumer packaged goods company explained. As a result, there is a gap between intentions and implementation. While 59 percent of our survey respondents believe their company should embed ESG issues into supply chain management, only 27 percent actually do.<sup>18</sup>

In the context of a fiercely competitive global environment where financial markets expect companies to meet performance targets every quarter, it is no surprise that the weaker signal of meeting ESG standards can get lost in the noise. For individual managers operating at the local level, the adverse consequences of missing production or cost targets often appear to be much greater than those associated with failing to meet some corporate level ESG norm – especially one that may have been promulgated remotely with little understanding of local realities.

These barriers often seem very hard to overcome. However, many businesses are generating creative and disciplined solutions. The best of these companies are now at the forefront of addressing issues such as water conservation, biodiversity management, finance for the poor, and AIDS. Some companies have developed an astonishing range of competence in fields that previously would have been viewed as being the domain of the public sector, and (in that context) might not have been subject to the same level of disciplined performance management and delivery.

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18 McKinsey UN Global Compact CEO Participant Survey 2007.

## Chapter Four: Leveling the playing field and competing to win



Despite the huge challenges that ESG issues pose, through our interviews and survey, we see emerging evidence of companies shaping the new game.<sup>19</sup> Pioneering global standards and frameworks – beginning with new metrics and support from financial markets – are leveling the playing field in an effort to make it easier for companies to incorporate ESG issues into their overall strategy. There is also increasing collaboration to address these enormous issues, often times building on unconventional partnerships, even between competitors. Additionally, businesses are doing what they do best – truly innovating to compete, this time for trust and leadership.

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### **FINANCIAL MEASUREMENT TO SET AND REWARD ESG PRIORITIES**

Financial markets are creating frameworks to measure and reward the positive contribution progress on ESG issues can make to the value of a corporation. Such standards help companies favor ESG issues as they balance strategic priorities.

While the capital markets have not yet mainstreamed ESG norms, there are many investor initiatives that encourage ESG activity. The investment firms supporting the *Principles for Responsible Investment*, for example, represent nearly \$8 trillion of global investments.<sup>20</sup> Signatories commit to incorporate environmental, social and governance issues into their investment analyses and decision-making processes. Pension funds are basing investments on these principles, which cover issues ranging from executive remuneration to transparency of corporate

<sup>19</sup> In our interviews we were encouraged by numerous projects which have the potential to be huge motors of social benefits. The examples are illustrations of the type of activity occurring but are not meant to represent a comprehensive set of best practice. We also include some examples of companies which have struggled along the learning curves in tackling some ESG issues but that are making significant progress.

<sup>20</sup> UN Global Compact website 2007.

information. In addition, initiatives such as the Goldman Sachs *Global ESG Framework* represent progress towards mainstreaming these concepts. Goldman Sachs' framework is designed to integrate ESG issues with industrial analysis and valuation on a sector-by-sector basis, and to identify investment opportunities related to alternative energy, water, and other emerging ESG issues. Initial indications are that the firms that Goldman Sachs identify as "Sustainable Investing Picks" outperform other companies in their respective industries. These initiatives still have to gain further traction – sustainability reports rarely highlight the most financially relevant issues, and investment initiatives and frameworks have yet to become part of the capital market mainstream – but current activity is promising.

### **COLLABORATING TO CREATE GUIDELINES AND ADDRESS ESG ISSUES**

Spurred in part by the scale of the ESG issues to address, businesses are collaborating to develop ESG standards, as well as collaborating on activities to fulfill them. Most businesses are facing overwhelmingly large ESG issues that span regions and industries, and threaten their long-term viability. More and more, businesses are collaborating to level the playing field – working in multi-sector partnerships with civil society organizations, governments, and each other.

Sometimes, this collaboration is within a broader coalition, where businesses abide by (if not develop) a guiding framework and benefit by working with other participants. Often these collaborations are around a specific ESG issue, such as water or transparency. Many CEO participants pointed to the Global Compact as one example of a coalition organized around a wider set of ESG issues. CEOs we spoke to stressed its role as an overarching global framework for companies to follow as they address ESG issues. They also highlighted the importance of UNGC regional forums, which often involve the UNDP and other UN agencies, in providing opportunities to collaborate with civil society and other businesses, and in sharing best practices.

**Companies are working with a wide range of partners, from competitors to NGOs**

Companies are working with a wide range of partners, from competitors to the NGOs whose criticism moved them to take action. The rules for engaging in partnerships have changed. As the CEO of a consumer packaged goods company describes it, "I think we are entering a new era here. The NGOs and businesses know that the confrontational ways of the past that were used to bring attention to the issues are behind us. The issues are out there. Now it's about solutions. Now we're saying we can do more by working together than by not working

together.” Companies often agree to work with competitors out of operational necessity in order to secure supply of human or natural resources. They then differentiate themselves on the basis of the resulting products they offer.

### **Partnering for sustainable solutions to address environmental issues**

An increasing number of companies are working with others to address issues from climate change to dwindling natural resources, such as fresh water. The global water shortage threatens every aspect of many businesses, including the world’s largest food and beverage companies. Recently, Danone, Unilever and Nestlé founded the Sustainable Agriculture Initiative (SAI). Peter Brabeck-Letmathe, Nestlé’s CEO, described to us how Nestlé agronomists are working with local communities in India, Pakistan and Africa to provide technical advice, foster learning and share best practices, particularly around water efficiency. Nestlé has seen cost savings through reduced water use and less need for waste-water treatment, while also safeguarding the quality and stability of supply and building its reputation as a socially responsible firm.

**“Now we’re saying we can do more by working together than by not working together”**

Another example of collaboration to create voluntary guidelines that address environmental issues is the Rainforest Alliance, which has certified more than 100 million acres of forest and farmland in over 60 countries. The certification builds in stakeholder input, standards and criteria from groups that include NGOs and academics, followed by local NGO audits. Meanwhile, the organization is “recognizing that the goal of certification cannot always be reached by those producers we’re most concerned about – the poorest and most remote,” as CEO Tensie Whelan explained. To that end, the Rainforest Alliance is partnering with companies to provide financial support to their suppliers in order to move them towards certification. This type of certification is just one example of metrics that help companies measure and get credit for their ESG work.

### **Joint investments in social development**

Many businesses are also partnering to tackle social issues ranging from human rights to infectious disease. Almost one decade ago, the Fair Labor Association was a groundbreaking example of a multi-stakeholder coalition, where companies, NGOs and universities began to collaborate to address labor practices.<sup>21</sup> Today, several Global Compact companies continue to work together on labor issues. There are also many well-known multi-stakeholder partnerships that combat public health issues. One example is the Global Fund to Fight AIDS, Tuberculosis and Malaria – a partnership between governments, civil society, the private

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21 Fair Labor Association website 2007.

sector and affected communities. The fund was created to dramatically increase resources to fight three of the world's most devastating diseases, and to direct those resources to areas of greatest need.<sup>22</sup>

### **Coming together to bridge the global governance gap**

Companies are also working with civil society, international organizations and the public sector to improve integrity standards. One example is the voluntary standards of the Business Principles for Countering Bribery, developed by a multi-stakeholder group under the leadership of Transparency International. Chair Huguette Labelle described how the involvement of many business leaders was critical in developing these principles. Another example is an effort to address corruption, a particularly important issue for the extractive industries. In 2002, the UK Government launched the Extractive Industries Transparency Initiative (EITI), and with the support of civil society and participants from the oil and gas industry now promotes the initiative. The EITI requires oil, gas and mining companies to disclose their net payments to governments, and governments to disclose revenue for resource access on a country-by-country basis. So far the EITI has signed up more than 24 countries rich in natural resources, as well as gathered support from business, industry associations, NGOs and investors around the world.

### **COMPETING FOR LEADERSHIP AND TRUST**

**Global companies  
realize the  
need to compete  
for a precious  
intangible capital  
– trust**

In a world where companies are rigorously scrutinized, where meticulously built brand reputations can be toppled by one poor judgment, global companies realize the need to compete for a precious intangible capital – trust. This need is all the more clear as companies confront local challenges in establishing ESG practices across their global operations. In the past, companies have established trust through philanthropic contributions, often disconnected from their business strategies. Now many companies are finding commercially viable models to manage the tension between the global and local dimensions of ESG and compete for trust to the benefit of society as well as their own bottom line.

### **New consumers**

Some businesses are beginning to understand the value of the “new” consumer, whether it is the world's poor, the environmentally or socially aware consumer, or growing population segments. These companies are profiting from providing services that were not always available to these consumer segments.

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<sup>22</sup> The Global Fund website 2007.

### *Base of the pyramid consumer*

Some companies are benefiting from the opportunity to serve what is called the Base of the Pyramid, more than 70 percent of the world's population with annual per capita incomes below \$3,000, who constitute a \$5 trillion global consumer market.<sup>23</sup> Yousseff Mansour, CEO of the Mansour Group in Egypt, spoke to us about the group's Kheir Zaman discount supermarkets, which serve low-income customers, often outside the major cities. The company felt it could build on the success, experience and existing supply chain of its more upscale Metro chain to serve this long-ignored segment of Egypt's population. The strong positive response to the first store led to the opening of seven more. The resulting increased volumes will give Mansour greater buying power, while increasing the motivation of its employees. Society benefits because consumers at the base of the pyramid gain access to good, affordable products while the stores create jobs and contribute to economic growth.

### *Ethical consumer*

Other companies are finding commercial opportunities by targeting so-called ethical consumers, people who make at least some buying decisions based on a company's social reputation. This has been particularly true in the food sector, where industry leaders have both developed their own product lines and acquired fast-growing "non-corporate" and "alternative" brands, from organic juices to socially-conscious snacks. Businesses themselves are also becoming ethical consumers. MAS Holdings, a Sri Lankan based apparel manufacturer, has attracted ethically minded global clothing brands as a result of its reputation for labor programs such as "Go Beyond." This program offers its 35,000 female employees (who make up 90 percent of the company's workforce) a wide range of courses focused on career development and work-life balance such as English, IT, emotional intelligence and managing the multiple roles of women in society. Chairman Mahesh Amalean said "we have attracted some of the better brands on the basis that we are maintaining higher standards than others."

**"We have attracted some of the better brands on the basis that we are maintaining higher standards than others"**

### *New consumer segments*

Finally, shifting demographics create opportunities to provide needed goods and services to growing population segments, such as the 580 million people across the world aged 60 or over. Financial services company HSBC is partnering with the Oxford Institute of Ageing (OIA) at Oxford University to produce the world's

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23 IFC & World Resource Institute report 2007, "The Next 4 Billion".

There are profitable opportunities to address climate change and natural resource constraints

largest global ageing study.<sup>24</sup> In the meantime, HSBC has begun to penetrate the segment by extending financial products created in OECD markets to people over the age of 60 in selected Asian countries.

#### Seizing ESG opportunities – at scale

Some companies are making major investments to seize profitable opportunities to address climate change and natural resource constraints. In a bid to capture share in the exploding market for biofuels (exports are predicted to grow 8 to 30 fold by 2020),<sup>25</sup> Brazil's Petrobras, a semi-public oil and gas company, has invested in bio-diesel plants, developed processing innovations and is a significant player in ethanol. CEO Sergio Gabrielli stated they are also “investing in infrastructure in Brazil to make it easier to export in large quantities,”<sup>26</sup> co-investing with the government in pipelines, waterways and vessels.

Other companies are gaining access to natural resources, and in the process, making contributions to the communities they are entering. Paul Skinner, the chairman of mining and resources company Rio Tinto, described how the company recognized the need for a deep-water port while it was constructing a mine in Madagascar in one of the poorest areas of one of the world's poorest countries. Rio Tinto realized that it could not afford to build the port, but also that the port would catalyze regional economic development. At the same time, the World Bank was considering implementing a development plan for Madagascar. The World Bank agreed to help finance the port if it could verify that the Rio Tinto mine would create sustainable social, economic and environmental development. A 5-year planning study concluded that the region had large potential – increasing output value by \$37 million and need for labor by 26,000 people – providing regional development investments were made alongside investment in the mine. Following the study, the Bank committed \$35 million to the port and an extra \$25 million to complementary regional development investment (for example, in irrigation and tourism), while Rio Tinto committed to a \$350 million investment in Madagascar.

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24 Researchers are interviewing 24,000 people in 20 countries about their attitudes to ageing and their behaviors during longer life spans. The study is aimed at building a cutting-edge research base on global ageing that will provide valuable information for policy and corporate decision makers.

25 “Positioning Brazil for Biofuels Success”, Vicente Assis, Heinz-Peter Elstrodt, Claudio Silva, *The McKinsey Quarterly* 2007 (from 6.5 billion liters in 2007 to 50–200 billion liters in 2020).

26 “Brazil hopes to build on its ethanol success”, *USA Today*, March 2006.

### **New way of measuring economics**

Some companies are developing new ways to measure non-traditional outputs which are crucial to their operations, such as environmental or community impact and workforce health. An example of a business practice which is measuring community impact to improve stakeholder relations is the work of Anglo American, a global mining and natural resource company, with Environmental Resource Management to develop a “socio-economic assessment toolbox” (SEAT). SEAT identifies key social and economic impact, helps develop a Community Engagement plan, and helps capture and inform best practices. Economic benefits are improved access, smoother project development, less remediation upon completion, and better use of local talent and resources.

Another example of a company managing ESG issues out of operational necessity is Areva, an energy conglomerate. Areva is a member of SIDA-Enterprises, a France-based pan-African initiative bringing together multinational corporations to address HIV/AIDS in their workforces. Areva CEO Anne Lauvergeon described a public/private partnership with the national government in Niger and ESTHER, a public health interest group based in France. The objectives of the partnership, in which her company is involved, is to support Niger’s policy of decentralizing care to HIV/AIDS sufferers, reinforce the capacities of the country’s public health system, and develop innovative means of relating with local stakeholders. Ms. Lauvergeon explained her company’s commitment to fighting HIV/AIDS: “Our responsibility is collective. We must all feel concerned if this illness is to be conquered and must tenaciously adopt a suitable and constant response.”

### **THE ROAD AHEAD**

We believe there is a huge prize available to business and society if a tipping point can be reached – one in which enlightened self-interest joins hands with increased trust in business to make way for greater mobilization of private resources against the biggest social challenges of our time. Business leaders, especially of the world’s largest corporations, have an unparalleled opportunity to lead. They have invested significant resources in building competitive advantage in the “intangible arena” of ESG norms, in learning how to partner with civil society players and in enhancing the social content of their brands. These players can only benefit from the rising tide of societal expectations on business.

However, we believe more than business leadership will be required. Civil society, the media, governments, labor movements, and investors will all have a role to play. Civil society organizations can help accelerate the trend towards mainstreaming

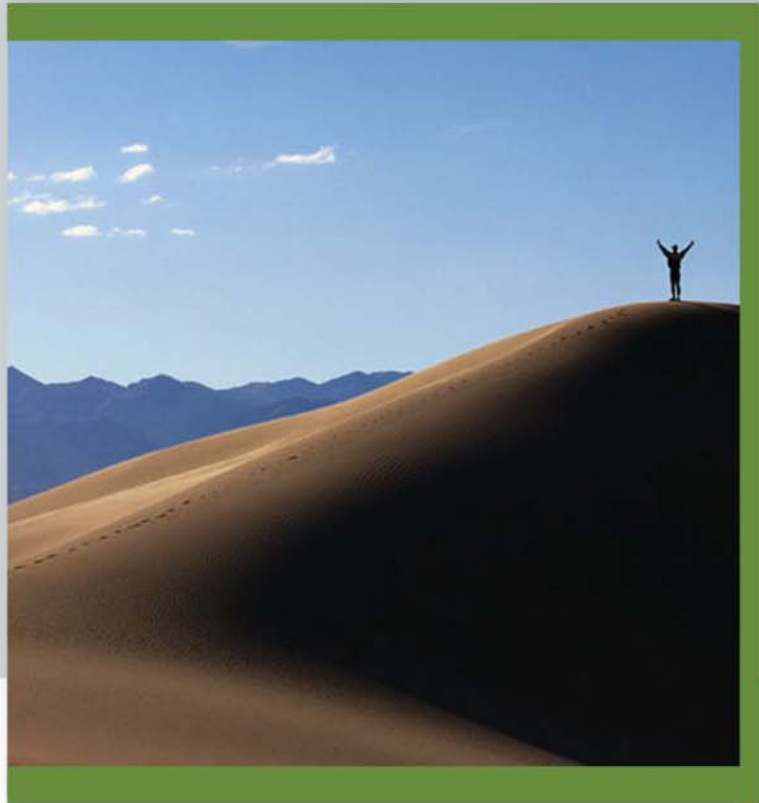
### **More than business leadership will be required**

higher ESG norms through developing their own portfolios of initiatives and experiments in working with business. Learning is required on both sides. The media has a hugely significant role to play, not least in influencing the attitudes of consumers and employees, holding companies to account for transgressions but also honestly laying out the contradictions and tradeoffs between what consumers say and do. Governments in developed and developing countries have a massive agenda to address in shaping markets in a way that harnesses private resources for the public good, while continuing to improve standards of accountability within their own public-sector enterprises. Labor movements will need to work through how best to handle the inherent conflict between the interests of workers in different countries, as more and more jobs become “open to global competition.” And finally, investors have a role in agreeing to standards for measuring ESG performance, and rewarding top performers.

Participant CEOs of the Global Compact have highlighted the special role the Compact can play in shaping the next era of ethical, market-based globalization. In our conversations, the Compact was viewed as uniquely positioned to help accelerate this journey. Interviewees stressed that among various “business in society” organizations, only the Compact has truly global reach, only the Compact has powerful local networks in countries as diverse as Bulgaria and Pakistan, and only the Compact provides a comprehensive framework. Participants urged the Compact to remain focused on its core mission, maintain real standards of club membership, and to communicate best practice and highlight members’ progress. The vision communicated by the CEOs we spoke with was of a partnership of some 4,000 organizations that, through the actions of its members, could provide an accelerated movement toward an ethical and inclusive global market economy.







**A huge prize is  
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