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UNITED NATIONS
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This report is intended strictly as a learning document and should not be interpreted to indicate either effective or ineffective practices.

Cover Photo: Adam Rogers / UNCDF

Foreword

IN JUNE 2003 a Global Compact Policy Dialogue gathered more than 200 representatives from business, civil society, academia and UN agencies at UN headquarters to identify problems and solutions related to supply chain management and partnerships. A final report on the outcomes of the dialogue – entitled “Supply Chain Management” – has been published on the Global Compact website www.unglobalcompact.org.

Following this policy dialogue, some Global Compact participants were invited to develop case studies describing their experiences with supply chain management, focusing especially on their relationships with small and medium-sized companies. These case studies were discussed during the International Learning Forum Meeting in Brazil (2003) and have been published on the Global Compact website. We hope that printing the studies will enable further distribution and help managers around the world to establish or improve their sustainable business linkages.

We wish to thank Anthony Ewing of the Columbia University, Wilfried Lütkenhorst of UNIDO and Marcelo Linguitte of *Instituto Ethos* for sharing their expertise. We would also like to thank the following companies, case authors and peer-reviewers: Escondida Mining Company in Chile, case author Hernán Blanco of the Rides Institute and peer-reviewer Professor Claudio Zaror of the University of Chile; Pão de Açúcar Group in Brazil, case authors Maria Coutinho de Arruda and Luiza Granado of the Fundação Getulio Vargas and peer-reviewer Professor Oddny Wiggen of the UN University; Renata Engineering Plastics and Metalman Auto in India, case authors Fernando Casado and Kai Bethke of UNIDO and peer-reviewer Lothar Rieth of the University of Tübingen, Germany.

We hope that all readers will benefit from the information and experiences collected here. We also hope to inspire teachers, trainers and academics to use the case studies for education, discussion and promotion of sustainable business linkages. Further information and new

case studies can be found on the Global Compact website at www.unglobalcompact.org.

Global Compact participating companies who would like to share their experiences in a case study, and academics interested in writing case studies or acting as peer-reviewers, are welcome to contact the Global Compact Office at globalcompact@un.org.

Ellen Kallinowsky
Head Learning Forum
April 2005

The Global Compact

The Global Compact asks companies to embrace, support and enact, within their sphere of influence, a set of core values in the areas of human rights, labour standards, the environment and anti-corruption. The principles are as follows:

Human Rights

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

Labour

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

Environment

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

Anti-Corruption

- Principle 10* | Businesses should work against corruption in all its forms, including extortion and bribery.

More information, including how to participate, is available on the Global Compact website at www.unglobalcompact.org.

Introduction

ANTHONY P. EWING*

SINCE ITS LAUNCH IN 2000 the Global Compact has brought together governments, the private sector and civil society to support a more sustainable and inclusive global economy. The Global Compact seeks to make widely accepted principles on human rights, labour and the environment a shared basis for commercial relationships.

Global Compact participants quickly identified supply chain management as a key challenge facing companies in global markets. The sheer complexity of many global supply chains presents a major obstacle to the widespread and consistent implementation of the Global Compact principles. How can large transnational companies encourage the adoption of human rights, labour and environmental standards among all of their suppliers? What can local governments do to encourage responsible supply chain management? Where do small companies fit in the global marketplace and how can they develop the necessary skills and capacity, first, to participate in global supply chains, and, second, to do so responsibly?

This publication, *Sustainable Supply Chains*, is a first step toward answering these questions and better understanding the distinct challenges facing

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The dilemma, of course, is that while SMEs account for the majority of businesses, employment and output in developing countries, many SMEs are unable to integrate themselves into the world economy and benefit from globalisation.

small and medium-sized enterprises (SMEs) that seek to implement the Global Compact. While large and small companies alike face similar issues when pursuing voluntary corporate responsibility initiatives, smaller companies confront unique obstacles. Small companies have fewer financial, technical and human resources. SMEs typically operate within a much narrower margin between business viability and business failure. Owners and managers of SMEs are more acutely sensitive than their counterparts at transnational corporations to issues such as market access, access to credit and financing and the immediate costs of improved social and environmental performance.

The corporate social responsibility movement has generated a great deal of scrutiny of transnational companies based in the world's largest economies. A number of the world's largest companies are Global Compact participants and transnational corporations face growing pressure to embrace core human rights, labour and environmental principles. These large well-known companies, however, represent a very small percentage of private sector economic activity in most of the world.

Small and medium-sized enterprises account for a sizeable portion of the private sector in most developing countries and are a principal source of new jobs in developing economies. Marcelo Linguitte, of Brazil's *Instituto Ethos*, highlights the central role of SMEs in the Brazilian economy, for example.

The dilemma, of course, is that while SMEs account for the majority of businesses, employment and output in developing countries, many SMEs are unable to integrate themselves into the world economy and benefit from globalisation. In his paper on business linkages, Wilfried Lütkenhorst of the United Nations Industrial Development Organization (UNIDO) highlights the power of global value chains to stimulate SME growth, provide productive employment and trigger productivity growth. Integration in global value chains, especially those driven by transnational corporations, is one of the most effective ways to promote development. Lütkenhorst distinguishes the low entry barriers and limited learning benefits of labour-intensive, buyer-driven chains from technology-intensive, producer-driven chains with higher barriers to entry but greater opportunities for knowledge transfer.

There are many obstacles, however, preventing the creation of beneficial linkages between SMEs and transnational companies. SMEs suffer

from insufficient information, skills and infrastructure. SMEs need tools to improve product quality, secure financing and build production capacity. According to Lütkenhorst, conducive government policies, strong supplier development programmes, good training institutions, appropriate financing and the assistance of business associations can support the efforts of SMEs to integrate themselves in global supply chains.

Corporate responsibility initiatives like the Global Compact and individual corporate programmes must support the role of SMEs. Lütkenhorst notes that while the cost of integrating SMEs cannot be borne by large companies alone, the development of a stable local supply base is in their commercial interest. Strategies that encourage local economic development benefit SMEs. Multi-stakeholder partnerships are a platform for promoting sustainable and responsible business linkages that benefit all parties. For corporate responsibility initiatives to contribute to international development, Lütkenhorst argues, the standards they promote must not be protectionist or discriminatory. At the same time, SMEs must not be allowed to operate in ways that undercut universal standards.

The case studies presented here are diverse and instructive. Five small and medium-sized suppliers to Escondida Mining Company of Chile pursue ISO 14001 environmental certification through the support of a public-private partnership. The largest retail supermarket chain in Brazil, Pão de Açúcar, launches a programme to identify and support small suppliers of sustainable Brazilian products. The case of two Indian auto parts manufacturers that received technical assistance from UNIDO showed the enhancement of their competitiveness to become suppliers to global markets.

The cases indicate that SMEs can be a powerful force for promoting social and environmental standards. The Pão de Açúcar programme to develop a new sales channel for natural and sustainable products is intended to contribute to the sustainable growth and development of suppliers and communities through higher income and capacity building. Pão de Açúcar worked with small suppliers to build the skills and capacity needed to qualify for the programme, which, according to the company, has had an indirect impact on more than 17,000 people. The programme also serves as a means to disseminate the Global Compact principles. An outcome of the Escondida case is the significant demonstration effect among suppliers of the benefits of good environmental practices.

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Consideration of the Global Compact principles is part of the training provided by UNIDO to small companies in the Indian automotive component industry. In the case presented here, two Indian companies that have signed on to the Global Compact have achieved improvements in business, quality, environmental and social performance. The UNIDO programme has widened the horizons of SME managers and made them more responsive to environmental and social concerns.

The cost of new initiatives and the cost-benefit calculus is a central concern in these cases. Transportation costs, for example, have proven to be an obstacle for participants in Pão de Açúcar's programme. Pão de Açúcar views its programme as a business initiative, not a social responsibility project and market factors will dictate the programme's ability to expand in the Brazilian market and beyond. The cost of monitoring social compliance by programme participants is, at this point, prohibitive. As a market-driven initiative, Pão de Açúcar has had to manage the commercial expectations of participants and assess the highly variable consumer demand for sustainable products. In the Escondida case, the participating SMEs have realised cost savings and productivity gains but express concern that their efforts have not led to more favourable business terms with their customer.

As is the case for large transnational companies, corporate responsibility programmes require strong leadership to succeed. Escondida, owned by major transnational extractive companies, was the first Chilean mining company to implement ISO 14001. The implementation of a corporate policy for environmental and social management by its corporate parent, BHP Billiton, was a key driver for Escondida's initiative aimed at SMEs. Another important factor was the personal commitment and individual leadership of the general managers of the participating SMEs.

Partnerships provide crucial support for initiatives aimed at SMEs. In the Escondida case, Chilean government policy promoting quality and environmental certification set the context for the initiative and the Chilean Economic Development Agency (CORFO) provided financial support to the SMEs to pursue certification. The company made its environmental consultants available to the companies, offered training and maintained regular communication with the SMEs. The Pão de Açúcar case identifies institutions such as the Sao Paulo Micro-Enterprise

Support Service (SEBRAE), the Brazilian Ministry of Environment and the United Nations Development Programme as potential partners in the *Caras do Brasil* programme.

Further research is needed to determine what SMEs are already doing in terms of responsible business practice, how their approaches differ from existing initiatives by large transnational companies and what tools they will need going forward. New tools are being developed to help SMEs become part of sustainable global supply chains. Brazil's *Instituto Ethos*, for example, has produced the Ethos Indicators of Corporate Social Responsibility as a benchmarking tool for small companies and has published a report, "Strengthening Social Responsibility in the Relationship between Large and Small Companies", that includes examples of successful partnerships involving supplier development, new business support, micro-credit and the establishment of associations of small suppliers. New approaches include integrating tools to improve social and environmental performance with tools to improve quality management and other business concerns of SMEs, such as technical and management upgrading, linked to quality, productivity and consumer demand. Monitoring and reporting are next steps for many SMEs, but as Wilfried Lütkenhorst emphasises, mechanisms must go beyond compliance tools to include education, training and capacity building. Importantly, large transnational companies may need to provide incentives and support to make compliance with stringent codes of conduct economically viable for their suppliers.

The challenge for Global Compact participants going forward is twofold – first, finding better ways to integrate SMEs in the global economy through supply chains and second, making these supply chains sustainable and consistent with the Global Compact principles.

If we can make progress on these two fronts and leverage the enormous potential of SMEs, then the Global Compact will have made an important contribution toward harnessing the benefits of globalisation for everyone.

UNIDO – Business linkages, supply chain management and SMEs

WILFRIED LÜTKENHORST, UNIDO

The context: Nature and importance of business linkages

BUSINESS LINKAGES ARE COMMONLY DEFINED as any commercial transaction taking place between different profit-oriented enterprises. As such they are vital elements for any economy to prosper and indeed even to exist. They provide the very basis for functioning markets and for economies to grow, diversify and, through rising levels of specialisation, to enhance their productivity.¹

Business linkages occur in many different forms. This paper addresses exclusively business linkages between transnational corporations (TNCs) and small and medium enterprises (SMEs). They can assume different manifestations², in particular:

- **Forward linkages with customers:** this may involve TNC investments into improving their marketing and distribution channels or forward linkages with industrial buyers (e.g. of machinery and equipment) where TNCs may provide extensive advice and even technical training on optimal use.

¹ See Stanton, David/Polarajko, Tony: *Business Linkages: Their Value, and Donor Approaches Towards Them*. UK Department for International Development, 2001.

² See Altenburg, Tilman, *Linkages and Spillovers between Transnational Corporations and Small and Medium-Sized Enterprises in Developing Countries – Opportunities and Policies*, in: UNCTAD, *TNC-SME Linkages for Development*, New York/ Geneva 2000.

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- **Linkages with technology partners:** through joint ventures, licensing agreements or other types of alliances, TNCs often engage in common projects with smaller companies. Such inter-firm technology cooperation is more common in industrialised countries but is also clearly spreading to developing countries (depending very much on the type of value chain involved).
- **Backward linkages with suppliers:** this concerns the sourcing of parts, components and services from SMEs, and in our context specifically from domestic SMEs in invested countries, thus enhancing local content of TNC production.

This paper will focus on backward linkages in global value chains, generally considered one of the most powerful mechanisms to stimulate SME growth, provide productive employment and trigger upgrading and productivity growth.

The role of global value chains for SME development

It has been observed that the globalisation process has gradually disconnected networks of production and finance from an overall system of global institutional relations thus producing a disequilibrium between the economic domain proper and the broader framework of shared values.³ In a closely connected development, as pointed out by Harvard economist Dani Rodrik, "international economic integration is taking place against the background of receding governments and diminished social obligations".⁴ Does this imply that we witness the emergence of increasingly hybrid governance structures in which social needs are no longer the exclusive realm of the state? While the social dimension has been an inherent feature in the European brand of post-war market economies ('social market economy' in Germany; 'planification' in France), we can now witness attempts to anchor responsible business practices in the corporate world itself, within a context of voluntary action.

Globalisation brings significant benefits to the world economy. However, it is also obvious that the distribution of those benefits is highly uneven, thus further increasing existing economic development gaps. The

³ Kell, G./Ruggie, J., *Global Markets and Social Legitimacy: The Case of the 'Global Compact'*, in: *Transnational Corporations*, Vol. 8, No. 3, December 1999, pp. 101-120.

⁴ Rodrik, D., *Survey on Globalization: Is Government Disappearing?*, in: *The Economist*, 29 September 2001, p.16.

benefits associated with the spread of new technologies and the large flows of foreign direct investment are being enjoyed by relatively few developing countries, while the majority of poor nations, especially in Africa, are being increasingly marginalised. Meeting this challenge of redressing the widening disparities and thereby contributing to efforts at poverty reduction, as expressed in the Millennium Development Goals, is a major concern of the UN system and, based on a platform of globally shared values and agreed principles of corporate social and environmental responsibility, stimulates action within the Global Compact. In this endeavour, SMEs play a critically important role.

To a great extent, improvements in the competitiveness of developing countries depend on enhancing and upgrading the contribution of SMEs, since these enterprises account for the majority of businesses, employment and output in these countries. Unfortunately, though these SMEs need to play a leading role in the economic turnaround of their countries, they are often unable to integrate themselves into the world economy and in fact are frequently hurt by globalisation, as imported products flood into their domestic markets. Their inability to benefit from globalisation is often ascribed to their low product quality standards, small production batches, limited access to finance and inadequate production facilities. However, these problems are only partly due to the shortcomings of the SMEs themselves and much of the problem can be traced to the weakness of the business environment in which they operate. Businesses need conducive government policies, strong suppliers, good training institutions, financing institutions that understand their requirements and business associations that can provide important services.

SMEs also need to cooperate with other businesses to undertake activities that will help to overcome the limitations imposed by their size. It is their isolation – their inability to make these links with other firms and with the support institutions in their business environment – that prevents SMEs from taking advantage of the opportunities that globalisation provides.

A related problem for many SMEs in developing countries is their inability to link with **global value chains**,⁵ especially those driven and

It is their isolation that prevents SMEs from taking advantage of the opportunities that globalisation provides.

⁵ Throughout this paper the following definitions will be applied:

Value chains are defined as the full range of activities that are required to bring a product or service from conception through the different phases of production, delivery to final consumers and disposal after use. (Continued on next page)

governed by large national or international corporations. These value chains make up a significant part of world production (currently estimated at more than 25%), and being unable to participate in these chains effectively excludes SMEs in developing countries from a large share of economic opportunities. Integration into these value chains represents one of the most effective ways of promoting the upgrading of developing country SMEs since such integration can provide them access to markets, upgraded technology, improved management practices and other benefits.⁶

In a somewhat stylised perspective, value chains may be of two types, buyer-driven and producer-driven. The type of value chain affects the economic benefits that the SMEs, and the country in which they operate, may receive. In (mostly trade-based) **buyer-driven chains**, large firms – often a large retailer – work with decentralised networks of SMEs as independent suppliers, mostly providing them with tight product specifications. This type of chain is often found in labour-intensive non-durable consumer goods industries such as garments, leather or toys. Entry barriers (in terms of technologies, capabilities and skills required) are relatively low, offering many opportunities for developing country producers capable of meeting the buyer's requirements. Conversely, however, the benefits in terms of technological learning from engaging in these chains tend to be quite limited. The main short-term development effect of participating in these chains is likely to be an increase in employment, though the lead firm can also help to tackle social and environmental issues such as child labour or environmental pollution, and participation in such value chains may offer SMEs a way to step-by-step upgrading of their capabilities.

In (mostly investment-based) **producer-driven chains**, the lead firm, typically a large one in a technology-intensive industry, exercises much closer control over its suppliers. When these are not wholly owned, joint ventures are a common form of cooperation and even where no equity

Depending on the features of the product and of its consumers, value chains can be confined to a single nation, or can span a region or the entire world.

Networks are groups of firms that cooperate on a joint development project complementing each other and specialising in order to overcome common problems, achieve collective efficiency and penetrate markets beyond their individual reach.

Clusters are sectoral and geographical concentrations of enterprises that produce and sell a range of related or complementary products and, thus, face common challenges and opportunities. These concentrations can give rise to external economies such as specialised suppliers of raw materials and components, a pool of sector-specific skills, or specialised technical, managerial and financial services.

⁶ UNIDO, Integrating SMEs in Global Value Chains. Towards Partnership for Development, Vienna, August 2001.

ties exist, joint value chain management systems are often introduced. Only the more advanced transitional economies and developing countries are likely to have the human and technical capacities needed by the lead firm, and the role of independent local producers will be more limited, though the technology and know-how transfer effects can be important. The automotive and electronics industries are examples of sectors with these types of chains. The main features of both types of value chains are summarised in Table 1.

Table 1 | Key features of producer- and buyer-driven value chains

| Characteristics | Producer-driven value | Buyer-driven |
|--------------------------------|------------------------------------|-------------------------|
| Drivers of global value chains | Industrial capital | Commercial capital |
| Core competences | Research & development; production | Design; marketing |
| Barriers to entry | Economies of scale | Economies of scope |
| Economic sectors | Consumer durables; capital goods | Consumer non-durables |
| Typical industries | Automobiles; computers | Apparel; footwear; toys |
| Main network links | Investment-based | Trade-based |

Integration of SMEs into global value chains generates both opportunities and risks. There is a danger that SMEs may be relegated to the role of mere suppliers of parts and components to large corporations thus possibly stifling their own innovation dynamics and exposing them to a high degree of dependency on the prime manufacturers to whom they supply. A careful assessment is therefore required to ensure that value chain integration does not run counter to SME development strategies focussing on the promotion of direct exporting capabilities. Both approaches have their merits and need to be reconciled by the prevailing national industrial development strategy.

Spill-over effects are strong when the SMEs that are part of the value chains form part of a local cluster of firms.

- TNCs may not be aware of potential business partners (this constitutes an information challenge that can be addressed e.g. by creating subcontracting exchanges).
- The second and third-tier small suppliers do not receive technical support, thus negatively affecting the performance of the entire supply chain.
- Awareness of standards may be lacking and/or the technical infrastructure for compliance (e.g. testing laboratories) may be insufficient.
- And, in a broader perspective, incentives may be biased against small businesses and their access to capital may be restrained.

Supply chain management, corporate social responsibility (CSR) and development: Private benefits and public goods

Integration into global and national value chains can provide significant opportunities for SMEs to upgrade their technology, management skills and market access, and to improve their financial condition. The extent to which the benefits are disseminated to society at large can vary considerably depending on the **spill-over effects** that result from the SMEs' participation in the value chain. These spill-over effects are likely to be particularly strong when the SMEs that are part of the value chains are linked in networks with other firms and institutions or, better still, form part of a local cluster of firms. The more dynamic the linkages among the members of the networks or clusters, the more likely it is that the knowledge, skills, market access and other benefits the SMEs obtain will be shared with others.

Conversely, SMEs that already engage in effective networking activities among themselves or are already members of a dynamic cluster will often find it easier to gain access to wider value chains, especially if the volumes of goods required by the buyers exceed the capacity of individual SMEs to supply. It is a clear result of recent research into the determinants of foreign investment that large corporations, in particular the leading "global players", are attracted to thriving business environments where they can rely on effective domestic supporting industries. This has indeed become a major factor in the locational competition for foreign investment:

"SMEs support the building up of systemic productive capacities and contribute to the creation of resilient economic systems in which small and large firms are interlinked. Such linkages and resulting clusters of large and small enterprises are of increasing importance for the attraction of foreign investment."⁷

"Many countries, in particular the poorer and least industrialised ones, risk becoming even more marginal to the dynamics of international production because they cannot meet the new requirements for attracting high quality foreign direct investment (FDI). Simply opening an economy

⁷ UNIDO, *Developing Industry: Productivity Enhancement for Social Advance*. UNIDO's Corporate Strategy, Vienna 2003, p.14.

is no longer enough. There is a need to develop attractive configurations of locational advantage.”⁸

Although the potential benefits to SMEs and to local and regional economies are large, and though large corporations, national and transnational, recognise the value of having good suppliers from developing countries, the linkage is often quite difficult to make. Large corporations (while to some extent operating limited vendor development programmes for their first-tier suppliers) usually cannot justify bearing alone the expense of upgrading entire local productive systems, which however is often required to reduce capability gaps. Also, the benefits cannot be completely appropriated at the firm level, thus assuming significant elements of a **public goods character**.

In reality, therefore, the development of business linkages between TNCs and SMEs” is impeded by market failures in the supply of information, skills and infrastructure”.⁹ This is largely due to the fact that quite abruptly, producers in developing countries are faced with quality and productivity requirements that do not yet apply to their domestic markets.¹⁰ Hence, there is a case for an intermediary to intervene and complement the market in creating sustainable business linkages.

Any such linkage support programme initiated by a neutral broker will need to adopt a sector-wide approach, strengthen existing service institutions, work with local partners and arrange for world-class expertise to be delivered to supplying SMEs.

Needless to say that the rationale for larger corporations, especially transnationals, to support upgrading of developing country SMEs is in their own commercial interest of developing a stable local supply base. Corporations will participate in upgrading programmes because it helps develop reliable, cost-effective partners and suppliers for their business. While compulsory domestic content regulations are gradually being removed in line with WTO provisions, TNCs operating in developing countries continue to have a commercial interest in local sourcing (on a voluntary basis). Incentives are manifold: from ensuring a continued

The development of business linkages between TNCs and SMEs “is impeded by market failures in the supply of information, skills and infrastructure”.

⁸ UNCTAD, World Investment Report 2001. Promoting Linkages, New York and Geneva 2001, p.xix. Stanton/Polatajko, op.cit.p.3.

⁹ Stanton/Polatajko, op.cit. p.3.

¹⁰ See Keessing, D./Lall, S., Marketing Manufactured Exports from Developing Countries: Learning Sequences and Public Support, in: Helleiner, G. (ed.), Trade Policy, Industrialization and Development, Oxford 1992.

There is a general consensus in the SME development literature¹¹ that for SME support programmes to be cost-effective and generate impact, these should:

- Adopt a sub-sectoral focus, i.e. preferably work with clusters of SMEs in the same industry;
- be based on market transactions, which should be reinforced and scaled up;
- be a matchmaker between demand and supply, *inter alia* through providing specialised information about SME capabilities (“subcontracting exchange”).

licence to operate, to reducing transport costs and optimising just-in-time delivery. However, acceptable quality at low cost and coupled with reliable delivery is a must for local suppliers to be accepted.

In addition, many corporations have developed long-term strategies of **corporate social responsibility** that address economic, social and environmental dimensions. Corporate social responsibility, therefore, becomes a strategic issue rather than just a reaction to pressure from the public.¹² Large corporations are not only aware of their impact on the economies and societies they are working in, but more and more they are consciously participating in local economic development initiatives. This trend has given rise to the notion of “responsible clusters”:

“Can corporate responsibility underpin the development of competitive clusters? The idea of ‘corporate responsibility clustering’ takes the model of synergies between competing companies to an altogether different level and into largely unexplored territory. It may be, for example, that companies based in countries with unusually intensive NGO climate become more knowledgeable about civil society and even more dynamic in identifying new product and process opportunities associated with social and environmental dimensions of performance. It is very likely that companies that have invested in partnerships with NGOs, trade unions and public bodies will be more competent in identifying and building profitable business partnerships.”¹³

The **UN Global Compact** is the internationally most visible example of large corporations’ acknowledgement of their corporate responsibility in the globalised economy. This leading UN initiative as well as others emanating from within the private sector (e.g. International Business Leaders Forum, Business Action for Sustainable Development, the Nordic Partnership or the Ethical Trading Initiative) are evidence that an increasing number of large corporations are concerned about the development of the societies and economies they are working in.

¹¹ See for example: Mead, Donald C./Liedholm, Carl, *The Dynamics of Micro and Small Enterprises in Developing Countries*, in: *World Development*, Vol. 26 (1998), pp. 61-74. and Altenburg, Tilman, *Promoting Ancillary Industries in Developing Countries*, in: *Small Enterprise Development*, Vol. 8 (1997), No. 2, pp. 24-33.

¹² See UNIDO, *Corporate Social Responsibility: Implications for Small and Medium Enterprises in Developing Countries*, Vienna, July 2002.

¹³ The Copenhagen Centre and Accountability, *Corporate Responsibility and the Competitive Advantage of Nations*, Copenhagen, July 2002, pp. 12 and 21.

Table 2 provides a synoptic view of the benefits for various stakeholders (SMEs themselves, local communities and large corporations) of the creation of sustainable business linkages.¹⁴

Table 2 | A triple-win scenario
Benefits of sustainable business linkages for SME development

| SMEs | Local cluster/business community | TNCs and/or large national corporations |
|--|---|--|
| Access to cutting edge know-how and technology | Enhanced local economic development | Broader access to more competitive suppliers |
| Enhanced skills and capacity | Increased employment and production | Reduced costs |
| Improved productivity | Long-term increase in competitiveness of the region | Strengthened supply chains |
| Access to new domestic and international markets | Consequent poverty reduction | Improved productivity |
| More diversified client structure | Added local purchasing power | Increased corporate responsibility combined with profitability |
| More stable relations to buyer organisations | Access to more competitive products | Enhanced reputation |
| Risk sharing through joint operations | Increased participation of private large scale actors in local business community development | Improved integration in new overseas markets |

The idea of 'corporate responsibility clustering' takes the model of synergies between competing companies to an altogether different level.

¹⁴Sources: Stanton, David and Polatajko, Tony, *Business Linkages: Their Value, and Donor Approaches Towards Them*, Department for International Development, London 2001 (mimeo); The Prince of Wales International Business Leaders Forum, *Business Linkages for Sustainable Development*, London 2001; UNIDO, *Business Partnerships for Industrial Development*, Vienna 2002.

The interface between
CSR and SMEs should

- a) Ensure that CSR standards are not protectionist or discriminatory in intention or impact and,
b) Integrate tools to improve social and environmental impact with tools to improve quality management.

Experience has shown that multi-stakeholder partnerships – involving TNCs, SMEs, development agencies, governments, research and civil society organisations – provide an excellent platform for promoting sustainable and responsible business linkages with a strong development impact. Such partnerships,¹⁵ like the one implemented by UNIDO in the Indian automotive component industry,¹⁶ have generated the following conclusions and lessons:

- The pooling and integration of different types of expertise (local and international; operational and analytical; economic, social and environmental) provided by the various partners ensures a holistic perspective on-development and constitutes an important asset of a partnership approach, as compared to more conventional modes of delivering technical cooperation.
- TNCs, beyond the narrow confines of their own supply chain, have a shared interest in upgrading the capabilities, and improving the tiering structure, of an entire industrial sector so as to improve their local sourcing potentials. This in turn can lead to significant cost savings (compared to either importing or in-house production of components) and, through providing local employment and technological upgrading, has broader development impact and can provide a welcome recognition as a good corporate citizen.
- SMEs can be motivated to participate in partnership programmes provided the incentives in terms of expected benefits are strong enough. This makes it essential to kick-start business linkage programmes with support services that generate quick, tangible and measurable impact without major capital requirements. SMEs want to see improvements in terms of productivity and quality, leading to increased sales and market shares. Furthermore, with clear benefits expected, SMEs are willing to pay for the support services provided.
- The demonstration of business benefits from a partnership programme widens the horizon of SME managers and makes them more responsive to a broader agenda addressing also environmental and social concerns. This is among the key lessons learnt in UNIDO's

¹⁵For an overview of different types of business partnerships see: *UNIDO/UN Global Compact/UNDP: Business Partnerships for Small Enterprise Development*, Report of a Workshop held in New York, 15-16 January 2004.

¹⁶See UNIDO, *Promoting Business Linkages in the Automotive Component Sector of India*, A Case Study submitted to the Global Compact Annual Learning Forum, Belo Horizonte, 9-11 December 2003.

India programme: a commitment to applying environmentally friendly processes, a commitment to waste minimisation, a commitment to reducing work-related accidents, a commitment to enlightened human resource development, e.g. through more emphasis on training – in essence a commitment to improving the impact of business on workers and on the environment is a result of instilling a longer-term perspective and vision and of developing a business case.

Outlook for a joint learning agenda: Moving TNCs and SMEs from business linkages towards business responsibility¹⁷

Within the “triple bottom line” of corporate performance it is perhaps surprising that it has been *economic* performance, in its broadest sense, which has been the least-understood element in terms of its implications for CSR. It is only recently beginning to be integrated with other CSR issues by some large companies. One important element of this includes actively supporting SMEs through business linkages and social investment, as well as influence on the public policy agenda. This means taking a more holistic approach to CSR where linkages at different levels of business operations are part of an overall strategy for the support of SMEs.

This is an emerging CSR issue for TNCs that are beginning to recognise that forming trading links and development partnerships, which help SMEs gain access to markets, finance, training, physical infrastructure and business support services, can be one of the key ways they can impact positively on poverty. A number of individual company and industry sector “business linkages” programmes have been developed in which TNCs contribute management expertise and training to boost the skill and standards of local companies and commit to stable trading relationships to help these businesses grow.

If CSR is truly going to become a strategic force in contributing to international development and eliminating the negative externalities of business, it must help to develop effective and viable approaches to Small Business Responsibility.

¹⁷This section draws on: UNIDO, *Corporate Social Responsibility. Implications for Small and Medium Enterprises in Developing Countries*, Vienna 2002, chapter 7.

It is crucial that:

- CSR supports the role of SMEs in development and does not serve as a tool to undermine and disadvantage them.
- SMEs are not able to undercut universal CSR standards and become a blind spot in which exploitative and environmentally destructive practises flourish.

“Socially responsible business in the North should consider prioritising their support to developing country supplier businesses in the form of management support and mentoring, which are of greater help than codes of practice.”¹⁸

Frameworks should be developed of “Small Business Responsibility” to understand and promote the positive social impact of SMEs.

The interface between CSR and SMEs has important implications both for organisations that are engaged in promoting and developing CSR and those engaged in supporting SME development. They should:

- Ensure that CSR standards are not protectionist or discriminatory in intention or impact. Internationally agreed standards such as the Universal Declaration of Human Rights and the Core ILO Conventions – as consolidated in the principles of the UN Global Compact – provide a basis for global CSR. What is now needed are management processes that are sensitive to the culture, environment and size of SMEs. SMEs need to be brought into the process of developing CSR standards and tools through consultation, partnership and piloting at a local level.
- Integrate tools to improve social and environmental impact with tools to improve quality management. This is beginning to happen at the cutting edge of CSR development in the North with the move from separate consideration of social, environmental and economic issues towards sustainability management and the increasing importance given to the business case. However, social and environmental pressure on suppliers tends to be piecemeal and unrelated to the business case.

CSR-oriented supply chain management initiatives should include support in quality management for SMEs and focus on the business case as well as on compliance mechanisms. As the Resource Centre for the Social Dimensions for Business Practise recently found in relation to their research in Tanzania, “Socially responsible business in the North should consider prioritising their support to developing country supplier businesses in the form of management support and mentoring, which are of greater help than codes of practice.”¹⁸

Equally, initiatives that focus on general business development, upgrading and training support for SMEs should integrate social and environmental management skills both in relation to entering into global value chains and serving local markets.

- Develop a framework of “Small Business Responsibility” to understand and promote the positive social impact of SMEs and in particular how to value, communicate, reward and improve the “silent social responsibility” which already prevails in many SMEs. This would integrate global supply chain pressures and linkages with

¹⁸Shankleman, J./Selby, S. *Understanding the poverty business interface: experiences from Tanzania*. London, Environmental Resources Management/Resource Centre for Socially Responsible Business, London 2001.

business case benefits and local accountability and the importance of SMEs in development. It would recognise that the structures, processes and initiatives which have proved effective (or at least popular) for TNCs may not work for SMEs, even in a scaled down form, since they face different issues and environments, and – crucially – wield different levels of influence. Given the different environment of SMEs, effective and viable CSR approaches will look and work differently from the CSR approaches that work for TNCs. The key therefore is to understand the inter-relationship between the two. One way in which a framework can be developed is to carry out empirical research into what SMEs are doing already in terms of responsible business practice. How are they engaging with stakeholders, contributing to local communities, environmental efficiency measures, etc.

- Strengthen the drivers for small business responsibility. CSR is already a “must do” for TNCs but for many SMEs there simply is not yet a pressing business case to devote resources to CSR in this way. Clearly, social and environmental improvements can have financial benefits. However, this should go hand in hand with technical and management upgrading and be clearly linked to quality, productivity and consumer demand. In some cases it may be necessary for TNCs to provide incentives and support, or change the nature of their buying relationship such as cost structures and turnaround times, in order to make compliance with their stringent codes of conduct economically viable for their suppliers.
- Promote enterprise development as a key CSR issue for TNCs. Enterprise development is a key area in which companies can contribute to “value creation” as opposed to “harm minimisation” and compliance approaches to CSR. This goes beyond philanthropy into strategic alignment, community involvement, stakeholder dialogue, partnerships, investment, institution building and public policy advocacy. While this has been picked up by a number of companies, it remains a low profile area of CSR where there has been relatively little development of initiatives, guidelines, research and standards compared to other areas of CSR. One reason for this may be the difficulty of distinguishing between what is “CSR” and what is a “profit-driven” initiative in this area and the commercially confidential information involved. However, as all aspects of CSR move away from philanthropy and closer to core business, this is likely to be a common issue to be overcome. Strategies for supporting enterprise development within a supply chain management framework can learn from existing forms of support for SMEs such as cluster and network development.

Drivers should be strengthened for small business responsibility.

Enterprise development should be promoted as a key CSR issue for TNCs.

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Instituto Ethos — Strengthening social responsibility in the relationship between large and small companies

MARCELO LINGUITTE, INSTITUTO ETHOS

Current scenario

BRAZIL FACES THE URGENT CHALLENGE of resuming growth while at the same time solving the problem of inequality and social exclusion. A key factor in the solution to this challenge is to strengthen small and micro enterprises (SMEs), the segment of the Brazilian economy that shows the most potential for creation of new jobs. Strengthening SMEs, in turn, depends on efforts of large-sized companies because they are often the most important business partners of SMEs.

A sustainable relationship between large-sized companies and SMEs requires the establishment of effective partnerships based on reliance and sustainability and allowing all stakeholders to grow and benefit from it. Modern economics has decisively influenced the relationships between small and large companies. Increasingly, supportive supply chains are creating favourable conditions for a sustainable relationship between large-sized companies and SMEs.

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Four million SMEs located in city areas account for approximately 20% of the Brazilian Gross National Product. An additional four million SMEs in farming areas absorb nearly 80% of the rural workforce.

Together, SMEs represent 98% of formal businesses and 45% of formal jobs in the country.

Based on estimates by the Brazilian Service for Support to Small Companies (Sebrae), there are approximately nine and a half million SMEs and 12 million informal employees in the country.

Large and small companies in the current economy

The Federal Constitution of Brazil provides that “small-sized companies organised under Brazilian laws, whose registered office and management are located in the country, shall have favoured treatment” (article 170 (IX)). However, laws passed in the 1990s were too diffident in creating more favourable conditions for SMEs.

A major obstacle for SMEs is the chronic financial hurdle caused by the lack of working capital, credit lines and loans. Larger companies can help to reduce such hurdles by offering reduced payment terms to small suppliers and favourable conditions to small customers. Banks can also contribute by facilitating SMEs’ access to credit lines and loans.

In addition, public policies can help SMEs by protecting them against predatory competition and granting them subsidies for research and development; occupational management, health and safety; government procurement; foreign trade and worker training. Public policies can also grant SMEs special access to investments, such as “supportive credit” policies, provided by credit cooperatives and micro-credit institutions. SME owners also have a role to play and should be encouraged to take an active stance by lobbying for these policies.

Current standing of relationships

During an interview conducted by *Instituto Ethos* with a number of companies, it was found that much still needed to be done to improve the relationship between large-sized companies and SMEs. For example, we found that only 22% of large companies interviewed had relationship-oriented policies for their SME suppliers and customers.

Nonetheless, large companies value their small partners. They allow SMEs to focus on their core businesses, compliment the quality of their products and services, provide flexibility and contribute know-how in their areas of specialty. Large companies also claim that they need to change their current rules and regulations in order to create favourable conditions for small businesses to grow. From their perspective it is of utmost importance that the federal government promotes changes in

regulations to lift some of the administrative, financial and labour costs incurred by SMEs.

On the other hand, SMEs interviewed described their large partners as too demanding and disloyal and explained that they were subject to the “survival of the fittest”. They added that large companies required too much from SMEs, including requirements large companies did not meet themselves. Finally, SMEs complained that constant cost cutting made it difficult to remain in business.

What could be done

Social responsibility indicators and the relationship between large and small companies

In order to improve relationships, large and small companies are invited to use *Ethos Indicators of Corporate Social Responsibility*¹⁹ as a benchmark.

Establishing clear ethical principles and value transparency is a critical element in the creation of a productive relationship between companies of different sizes. Managers, especially in large organisations, must commit to this goal and develop uninterrupted communication with suppliers and customers in order to educate them on the company’s strategic plan and to provide them with clear information on what commitment is expected from them. Meeting such requirements is a guarantee of mutual reliance and it is critical to the management of both businesses.

Large companies can take several actions to strengthen their SME partners, including training and education. For example, large companies can refer their partners to institutions that offer support and development-oriented programmes. This will help SMEs to grow and qualify as socially responsible together with large companies.

It is, however, necessary for large companies to factor in individual conditions faced by small suppliers and from the setting of selection and evaluation criteria onwards to keep individualised relationships with small partners. Assisting with and supporting adjustments of partners, giving time to adjust to new requirements and paying fair remuneration for

¹⁹The manual suggests a few examples of step-by-step programme designs that value such relationships and is available at www.ethos.org.br.

22% of large companies interviewed had relationship-oriented policies for their SME suppliers and customers.

SMEs interviewed described their large partners as too demanding and disloyal.

Large companies need to ensure that their outsourced labour suppliers afford those workers conditions equivalent to those enjoyed by permanent employees.

services or products are of the essence in protecting the good health of small suppliers. Likewise, large companies need to ensure that their outsourced labour suppliers afford those workers conditions equivalent to those enjoyed by permanent employees. Developing in-house diversity programmes in large companies may also set an example to follow and influence small partners' culture.

Most often small businesses represent a majority of large companies' customers. It is therefore in large companies' best interest to develop and implement supply conditions that are fair and supportive of small customers' sustainability. SME customers, in turn, need easier access to large companies through efficient communication channels. This communication should create a culture of responsibility and transparency in the relationship between large and small companies.

Thorough joint planning by large companies and small suppliers can lead to even more efficient prevention of environmental damage, encourage safe disposal of waste and recycling; materials reuse and rationalisation of input use throughout the production chain. Companies can diversify their environmental efforts by supporting small businesses in their communities that promote social inclusion and contribute to environmental protection.

When settling in an area, large companies impact the environment and the entire trade network. It is therefore important that they conduct prior studies on how to mitigate adverse impacts and allow planning of future efforts in support of existing small businesses. Companies may, for instance, carry out research with a view to identifying commercial needs in the community and finding the profile of new businesses to be supported in the future. Alternatively, large companies can partner with small local companies to get involved with communal life and to implement social and other projects in support of public policies, including encouragement of volunteer work.

Internally, large companies must ensure that employees in charge of relationships with small suppliers and customers participate in the drafting of policies intended to improve that relationship. Also, should the need arise to downsize the workforce, large companies should offer programmes to encourage entrepreneurship.

What has been done

Instituto Ethos has published a manual entitled *Como Fortalecer a Responsabilidade Social Nas Relações Entre Grandes e Pequenas Empresas* (Strengthening Social Responsibility in the relationship between Large and Small Companies).

This manual is based on a study conducted by *Instituto Ethos*, in a partnership with Sebrae (the Brazilian Service for Support to Small Companies), on the different roles of small and large companies in the current economy. The manual shows how Ethos indicators of corporate social responsibility can be used to guide the relationship between companies of different sizes, including certification requirements. The manual provides examples of successful efforts implemented by large and small companies that could be used as reference or a source of inspiration for socially responsible corporate practices.

The manual also informs on several tools used to strengthen socially responsible relationships, such as the SA8000 and AA1000 certifications and fair trade. It lists 14 actions that have improved relations between large and small companies.

The diversity of efforts shows a wide range of options available to companies willing to act in a socially responsible manner with their partners in production and supply chains. Some of these efforts include supplier development, support to new businesses, micro-credit, incentive to supportive trade, integration and exchange of information between large and small companies, associations of small suppliers to reduce operating costs and offer better prices, not to mention projects for digital inclusion, eradication of child labour and fund raising by non-governmental organisations.

For more information please check the *Instituto Ethos* Website www.ethos.org.br or contact Marcelo Linguitte directly at milinguitte@ethos.org.br.

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Case Studies

Escondida Mining Company in Chile: How can large companies contribute to environmental improvements in SME suppliers and contractors – The case of ISO 14001

December 2003

CASE AUTHOR

HERNÁN BLANCO

RECURSOS E INVESTIGACIÓN PARA EL DESARROLLO SUSTENABLE (RIDES)

PEER-REVIEWER

CLAUDIO ZARÓR, UNIVERSITY OF CHILE

“We challenged the governing paradigm in the Chilean public sector of ISO 14001 being only appropriate for large companies.”

Andres Camaño
Environmental Affairs
Manager
Escondida

SMEs are an important economic and social actor in Chile: according to their annual sales, 82% of all industrial facilities are micro companies, 17% are SMEs and only one percent are large companies. The prevalent precarious financial situation – limited access to credit – together with the lack of information, know-how and technology has conspired against the implementation of standardisation procedures in this sector (Leal, 2003).

Abstract

THIS CASE DESCRIBES the certification process in ISO 14001 of five small and medium-sized suppliers to Escondida mining company. It is an interesting private-public collaboration experience. In terms of the company, the case represents an application of the three environmental GC principles, with particular relevancy to the 8th principle (“undertake initiatives to promote greater environmental responsibility”).

Main stakeholders are:

- Escondida mining company staff in charge of the certification initiative;
- small and medium-sized suppliers that went through the certification process;
- the Chilean development agency, CORFO;
- the company which carried out the certification process: DNV.

The context

It is a widely held belief ISO 14001 would be appropriate exclusively to large companies. As a paper produced by ISO states, based on the results of several international workshops analysing the problems that SMEs have with ISO 14001, the standard is difficult to understand, adopt and use. Three categories of problems were identified: company-internal obstacles to implementation, company-external obstacles and the standard's lack of user-friendliness (Jensen, 1999).

The study quoted considered that companies with fewer than 200 employees are considered SME. ISO defines SME as companies with fewer than 500 employees. In Chile, on the other hand, SMEs are companies with annual sales between 65-thousand and 2.7 million US dollars. This latter definition tends to be much more restrictive and sets a very clear economic and social profile for SMEs. In this sense, for example, most of SMEs are – or originally were – family enterprises.

This case study constitutes evidence in favour of the feasibility of SMEs' environmental certification. It describes an interesting experience of joint collaboration between public and private actors for ISO 14001 certification of five small suppliers of the Escondida mining company in the Antofagasta region in Chile.

A number of context elements have played an important role. The following two are among the most relevant.

Chile's trade liberalisation process

Chile has championed trade liberalisation in the region (and world-wide). Since the early days of the dictatorship (1973-1989), Chile started deep reforms to open its economy. The foreign investment decree of 1974 and the mining code of 1983 are examples. Chile sustains a rapid liberalisation pace, having subscribed to trade agreements with countries in all continents. Environmental certification, in this sense, is gaining increasing importance. As posed by the regional director of the Chilean economic development agency CORFO: Certification [both quality and environmental] is crucial in the context of trade agreements subscribed by Chile. Certification initiatives started about four years ago (with main focus in the Antofagasta region). They are a result of the presidential mandate that sets a goal of 1,000 certified enterprises by the end of President Lagos' administration. CORFO will contribute to this goal by supporting 600 enterprises. [Cristian Figueroa, Director, Regional development agency, October 2003.]

The peculiarities of the Chilean mining sector

A great percentage of national copper production – equivalent to 35% of world copper production – comes from the Antofagasta region (125,000 square kilometres). Copper makes up about 40% of Chilean exports and seven percent of its GDP. There are official, long-term, public-private initiatives to consolidate a mining cluster in the region. The cluster involves diverse sectors, particularly services, which support mining production and involve SMEs. The idea of the cluster has been discussed widely, even with the support and thrust of international organisations such as the United Nations Economic Commission for Latin America and the Caribbean (CEPAL), and it is now quite rooted in regional public and private institutions. One of the main challenges – as acknowledged by CORFO's regional director – is to devise stronger chains between large companies and suppliers in order to keep more wealth in the region.²⁰

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²⁰Only eight percent of the annual regional income is kept in the region (personal communication, Cristian Figueroa, CORFO, October, 2003).

Escondida was the first mining company in Chile to implement ISO 14001 in one of its operations.

It is also among the few mining companies that pay taxes in Chile.

The company

Escondida mining company is at present the mine with the world's highest copper production. It joined the Global Compact in September 2003. Main characteristics of the company are included in Table 1.

Table 1 | Escondida mining company

| | |
|---------------------------|--|
| Industry | Minerals and metals |
| Major products | Copper concentrates and copper cathodes. Installed production capacity is 1,250,000 tonnes of copper per annum, as concentrate and cathodes. |
| Age | Mine discovery: 1981. Mine facilities construction: 1988-1990. Total investment to December 2002: US\$ 3.8 billion. |
| Location | 170 kms southeast of Antofagasta. |
| Owners | BHP Escondida inc (57.5%), Rio Tinto Escondida Limited (30%), Japan Escondida Corporation (10%), International Finance Corporation (2.5%). |
| Personnel | 2,345 (direct); 1,847 (contractors). |
| Sales and revenues | US\$ 143.6 million (December 2002); US\$ 192 million (December 2001). 2002 was an anomalous year because of a particularly low international copper price. |
| Major competitors | Codelco Chile, formerly the world's biggest copper mining company, state-owned. |
| Market share | 20% of Chile's total copper production in 2002. |
| Company website | www.mel.cl |

Source: Minera Escondida, 2002

Key company decision makers featured in this case are:

- Escondida's environmental consultant to the concentrates facility, Marcelo Stocker. He was the person with the most direct contact with SME suppliers. His experience was crucial in order to anticipate the benefits of this initiative.
- Environmental affairs manager, Andrés Camaño. He worked closely with the environmental consultant and was the bridge to the higher management in order to get the support and resources for this initiative.

- CEO, Bruce Turner, who consistently and right from the beginning supported this initiative.

Escondida's corporate reputation in Chile is highly respected. In a sector with a controversial environmental and social record – mining – the company has led innovative ways of dealing with environmental and social issues. The company has also had a significant positive effect in the development of the city of Antofagasta.

Escondida was the first mining company in Chile to implement ISO 14001 in one of its operations. It was also the first to create an independent foundation to channel the bulk of its social contributions.²¹ Up to December 2003 it was the only mining company in Chile signed up to the Global Compact. It is also among the few mining companies that pay taxes in Chile, totalling more than US\$ 1.6 billion in the period 1990-2002.

There is a general positive perception of the human characteristics of the company. As one of the managers of one SME supplier put it: Escondida is a company of people [Andrés Jensen, SME Jensen Ingeniería, General manager, October 2003].

CORFO – Chilean Development Agency

The Chilean Economic Development Agency (CORFO) was founded in 1939 to promote productive activities in Chile. It supports economic development by encouraging competitiveness and investment, contributing to the generation of more and better jobs and equal opportunity for productive modernisation.

CORFO makes various financial instruments available to the business community, including long-term credits and co-financing. Co-financing partially covers the cost of business modernisation efforts. They require companies to make a growing contribution over time to ensure that the initiatives supported are of real use to the beneficiaries.

CORFO was a crucial actor in this certification experience. It was thanks to one of CORFO's programmes (PROFO, development projects) that SMEs could get governmental financial support to embark on the certification initiative.

²¹ Since its creation in 1996, Escondida's foundation has provided more than US\$ 20 million to community projects in education, health, social development, indigenous development, local development and youth (www.fme.cl)

The SMEs

The main characteristics of the five enterprises that take part in the certification project are:

- Annual sales range from US\$ 200,000 to US\$ three million.
- Number of employees range from 10 to 58.
- With one exception (WEIR-VULCO), they are owned by Chilean capital.
- Two are dedicated to electric projects and maintenance; one car rental, one industrial equipment manufacturer and one industrial environmental and cleaning services and equipment.
- With one exception (AMFFAL), they have all been suppliers to Escondida.

Despite the evident differences in the SMEs, they proved to have a number of similar concerns and aspirations, particularly in environmental terms.

Having close
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The consultants

Three groups of different consultants were involved in this project:

- Consultants hired within the PROFO programme (regional consulting firm SGL).
- Permanent external consultants to Escondida, which shared with the SMEs during the PROFO (national firm *MAC Consultores*).
- Chilean office of international certifying firm, DNV (Det Norske Veritas), who granted the ISO 14001 certificate.

The events

Rather than handing out fish, our aim was to teach our SME suppliers how to fish.

[Andrés Camaño, Escondida's environmental affairs manager, October 2003].

The internal conviction that in order to be successful the company had to implement the most stringent environmental and social international standards moved Escondida, back in 1999, to start certifying its facilities under ISO 14001.

Having close to 2,000 supplier and contractor enterprises – mainly SMEs – it soon became evident that much would be gained if suppliers had systematic ways to manage their risks. And the benefits would also accrue to the SMEs; it would be a win-win situation.

The certification process was possible thanks to a specific governmental support programme, called PROFO – associated development programmes – which partially funded the expenses. CORFO disburses the funds, which are administrated by a CORFO-authorized regional operator. The maximum available funds are approximately US\$ 68,000. Operators can be public or private (or public-private) organisations. In the Antofagasta region there are two authorised operators: SERCOTEC (public, www.sercotec.cl) and CDP (private, www.cdp.cl).

PROFOs have a preliminary phase called PREPROFO. Its objective is basically to provide an opportunity as well as time and resources so that enterprises that are part of the PROFO get to know each other and can pursue a preliminary environmental diagnosis.

Escondida learnt about this opportunity for governmental support and in August 2000 invited a sample of 100 of its suppliers to join such an initiative. Seven enterprises accepted signed on.²² They started the first

²²These were IMECO, COMIN, AMECO, Jensen Ingeniería, SALFA, Galleguillos y Ardiles and WEIR-VULCO.

phase in December 2000 and finished in February 2001. The programme was managed by SERCOTEC. CORFO funded 80% of the project budget and the rest was contributed by the SMEs (approximately US\$ 14,000).

It was difficult to get the process going and to have the enterprises agreeing with the importance of such an initiative.

During 2001 the process did not make much progress. SERCOTEC presented proposals to CORFO for the second phase (the PROFO), but these were consistently rejected. One of the reasons was that SERCOTEC had been specialising in other issues (particularly micro enterprises). CORFO eventually did not want to keep working with SERCOTEC in this specific task and wanted to try other options.

Additionally, there was confusion and indecision regarding the extent to which non-SMEs, larger enterprises,²³ could be part of the PROFO.

Two facts contributed to this situation:

- CORFO allows 30% of the enterprises part of a PROFO to be non-SMEs – this limit was exceeded in the second phase;
- During the final phase of certification, the national CORFO office had not defined the criterion for non-SMEs funding of ISO 14001 certification.

In the meanwhile – and possibly due to the delay and lack of definition – three enterprises quit the initiative, leaving four in it. To continue with the PROFO, CORFO required that a minimum of six enterprises be involved. In August 2001 two other SMEs were added to the initiative.²⁴

Between August 2001 and January 2002 the SMEs were compiling and completing the required information to comply with CORFO's proceedings. During 2001 Escondida was in the process of getting the ISO 14001 certificate for two of its facilities: the oxides plant and the mine site. Escondida's staff was therefore limited in their availability to assist the SMEs.

In January 2002 the PROFO started. CORFO funded 70% (approximately \$ 42,000) of the total costs and the SMEs contributed the rest. Escondida was actively involved in this phase of the project, making its environmental consultants available to the SMEs, offering periodic training workshops and keeping close and periodic contact with the SMEs involved.

During 2001

Escondida was in the process of getting the ISO 14001 certificate for two of its facilities:

Escondida's staff was therefore limited in their availability to assist the SMEs.

²³WEIR-VULCO and SALFA fall out of CORFO's classification for SMEs.

²⁴These were BECHTEL and JAMFFAL. BECHTEL completed the PROFO but did not get to the end of the process, the ISO 14001 certification.

“As long as our suppliers and contractors manage their risks, all of us benefit.”

Andrés Camaño
Environmental Affairs
Manager
Escondida

“If we can avoid harming the environment we ought to do it.”

Andres Jensen
General Manager
Jensen Ingeniería

“We want to be leading actors more than simple spectators in environmental issues.”

Patricio Mora
General Manager
SALFA

Escondida considered that the certification process had already taken longer than necessary, so it offered the SMEs to complete the PROFO in time to get the certificate before the end of the year. To motivate SMEs to meet with this target, Escondida offered to pay for the expenses not covered by CORFO for the final phase: the certification itself.

The PROFO was completed in October 2002 and the certification – the third and final phase – occurred in November of the same year. For this phase CORFO covered 60% of the actual certification costs of the three smallest enterprises²⁵ and Escondida funded the rest. The biggest SMEs²⁶ received all the required funding directly from Escondida, as the company had promised.

Escondida estimates a total expenditure, from the start of the PROFO initiative until the enterprises gained the certificate, of \$ 14,000 (Andres Camaño, Escondida’s environmental affairs manager, personal communication, October 2003). This estimation only includes extra money disbursed by the company and does not include several in-kind contributions such as staff time, training time, room and equipment rent, etc.

Escondida’s drivers and motivations

A number of previous events and initiatives within and outside the company had shaped the events that culminated in this initiative. The following are worth mentioning:

- The implementation at the corporate level – within BHP Billiton – of the HSEC (health, safety, environment and community) policy for environmental and social management.²⁷ The HSEC criteria will be adopted inside the company and also outside, as a benchmark in the selection of suppliers and contractors. It is expected to be fully implemented by the end of 2003.
- 2002 work accident at mine site (one fatality).
- Escondida’s programme “zero harm”. It is a one-year programme coordinated by Escondida’s vice-presidency aimed at minimising all risks and moving towards zero harm in all operations.
- Mining cluster initiative. As already explained, it is a private-public initiative in the Antofagasta region. The main goal is to generate a chain of activities (provision of goods and services) for the mining

²⁵These are Jensen Ingeniería, Galleguillos y Ardiiles and AMPEAL.

²⁶WEIR-VULCO and SALFA.

²⁷The HSEC is essentially a permanent programme to manage risks in the different enterprises.

sector. It is expected that the cluster will foster local and national SMEs. The initiative is strongly supported by the regional government, as well as by the main mining companies.

- Escondida's policy statement, which declares the company's aspirations, requirements for growing and making progress, values and criteria to achieve success.

While Escondida employs more than 2,000 people, the team that directly pushed this project forward was extremely limited. No more than three staff members – environmental consultant, environmental affairs manager and the CEO – were responsible for this initiative. They actually admitted that, although they did not find resistance in other company departments or among the staff, most were sceptical of the utility and feasibility of such efforts. The sceptics changed their attitude once the project was finished.

SME's drivers and motivations

The group of SMEs involved in this case share an atypical feature: the majority of the general managers have a personal concern for the environment. Andres Jensen (Jensen Ingeniería) recalls his childhood and the way his Danish father used to instil respect for the environment in his children. Gabriel Galleguillos (Galleguillos y Ardiles) has great memories of a primary school teacher who taught him the importance of nature. Patricio Mora (SALFA), having no more than 15 years in Antofagasta, feels already part of this region and wishes to be able to contribute to a better environment for his children and descendants.

Other drivers the SMEs identified:

- Escondida's invitation and support to embark on this initiative.
- The possibility to be at the forefront and capitalise a competitive advantage.
- The context of trade liberalisation and the opportunities that environmental certification could bring. Some interviewees give more importance to environmental certification than to quality certification. Quality – they argue – has to be already internalised in order to be reasonably competitive.

In general, SMEs shared the same views, concerns and approaches to this project. Illustrative of this is that they name building deep and solid relationships to each other as a valuable by-product.

Escondida's policy statement contains a number of elements aligned with this initiative:

- "Our purpose is to create value for our shareholders, **communities**, clients..."
- "Our growth and progress requires that we gain trust from our employees, clients, **suppliers**, communities..."
- "We look after mutual-benefit relationships..."
- "We are successful when our clients and **suppliers** are benefited by our business relationships."

"The certificate has a value in itself but I have realised that there are intangibles that enterprises have valued; the experience has confirmed that it is possible to have a friendly relationship AND an efficient contractor-supplier (Escondida-SMEs) relationship."

Andres Camaño
Environmental Affairs Manager
Escondida

"[ISO 14001 certification] has allowed us to organise internally."

Oscar Pino
General Manager
AMFFAL

The ISO 14001 certificate will be the top score a contractor can achieve in regard to environmental criteria.

Results and impacts

Even though it is a recent process, all the SMEs involved already identify concrete **positive impacts** as a result of ISO 14001 implementation. WEIR-VULCO has quantified some impacts: annual cost savings of \$36,000 in water, energy and fuel, and fewer accidents. SALFA estimates savings of up to 15% in energy and water consumption.

Other outcomes reported by the SMEs include:

- Efficient use of raw materials,
- good practices for training of employees,
- fewer purchases in hardware stores,
- less social security expenses (because of fewer accidents),
- better internal organisation and service to clients.

A number of other less quantifiable but relevant impacts must be highlighted. The following quote is an illustration of this:

This enterprise has changed after certification; we are not the same anymore. People are relating in a different way. [Patricio Mora, SALFA's general manager, October 2003].

Other non-quantifiable positive impacts include:

- Better relationship with employees,
- good practices have also reached the employees' families,
- other big mining companies have acknowledged the certificate in their contracting decisions,
- better relationships with other SMEs,
- a confirmation (to Escondida) of the benefits of partnering with contractors and suppliers,
- high management is now convinced about the importance of good environmental practices (SALFA),
- implementation of other, related good practices such as housekeeping and lean thinking (WEIR-VULCO),
- in the case of WEIR-VULCO, the international parent company (WEIR Minerals) has now requested that all subsidiaries implement ISO 14001.

SMEs are also appreciative of the opportunity that the process has brought about for building constructive and friendly relationships among them:

Currently we are good friends with each other SMEs. [Andrés Jensen, Jensen Ingenieria's general manager, October 2003].

When the SMEs were asked about the impacts of this experience, they spontaneously highlighted positive effects.

When queried about **negative impacts**, one issue emerged. There is a generally shared concern as to the contracting benefits with Escondida that certification should entail to SMEs. By the beginning of the certification project, Escondida had declared that the long-term aim was to have SMEs becoming strategic partners to the company. This status would entail a number of privileges, such as longer contracts. The prevalent perception is that the ISO 14001 certificate has not, so far, meant further privileges or rewards to the SMEs, in comparison to those SMEs without a certificate. SMEs feel somehow disappointed in that – they argue – Escondida has not so far considered the certificate in contracting decisions, continuing to make cost the only or most important criterion.

Escondida, on the other hand, argues that this is a transition period. The company is in the process of systematising the contracting procedures. Within the HSEC policy, by the end of 2003 there will be a revised contracting process, which will include 15 criteria (covering health, safety, environment and community issues) for assessing contractors' bids. The ISO 14001 certificate will be the top score a contractor can achieve in regard to environmental criteria. This new contracting process will determine the status of strategic partners.

Escondida further argues that, having more than 2,000 employees and close to 2,000 contractors, it is a big challenge and takes time to change internal procedures. The company is, however, convinced about the benefits of this initiative and is fully committed to it. At present – almost one year after the certification – Escondida is assisting the five companies in their quest to have certification extended for three more years, irrespective of whether the SMEs keep contracts with Escondida.

Finally, there is a further, very significant outcome of this certification project. At present, Escondida, CORFO and 42 SME suppliers²⁸ are embarked on a Supplier Development Programme (PDP by its Spanish acronym), another CORFO instrument. It is a one-year programme aimed at the implementation of Escondida's internal HSEC policy. CORFO contributes with a maximum of \$ 2,700 per enterprise, and a total maximum of \$ 82,000.

²⁸ The five original enterprises are also participating; not all the enterprises are SMEs.

*“We seek to be valued
by the communities
where we are working.”*

*Large companies are in the
process of rationalising
contractors and suppliers.
They have experienced that it
is hardly manageable to have
numerous suppliers.*

*Escondida's CEO puts
it clearly: “When
business is done
responsibly everybody
has something to gain.”*

Strengths²⁹

- SMEs mutual support and efficient team work to complete the project.
- SMEs' top management commitment to this initiative (personal passion for the environment).
- Governmental support through CORFO.
- Professional qualifications of the consultants.
- Escondida's support and the fact that the company had already implemented ISO 14001.

Strengths and weaknesses

The analysis of strengths and weaknesses below might help to shed light on how this kind of process could be implemented and revised in different contexts.

Final remarks

It is essential to keep our 'social license' to operate, especially in the context of international trade. [For example,] in China they will know what we are doing in Chile. [Bruce Turner, Escondida's CEO.]

Four issues are considered here:

- How does the concept of 'sustainable supply chain approach' (SSCA) express in this case?
- What are some of the main challenges that this case uncovers?
- What are some recommendations for future similar initiatives?
- How is this experience related to the Global Compact principles?

In the words of Escondida's CEO, this project is a concrete demonstration of what the company understands by 'Sustainable Supply Chain Approach'.

This approach is considered of utmost importance. A number of initiatives where the company is very active are envisaged as components of the Sustainable Supply Chain Approach, in particular:

- HSEC policy implementation,
- Escondida's 'zero harm' programme,
- the public-private regional initiative for a 'mining cluster'
- and Escondida's policy statement in itself.

The business case for 'Sustainable Supply Chain Approach' is therefore quite straightforward. If contractors and suppliers improve, everybody benefits.

As to why all this interaction with the broader company's 'community', the CEO explains:

We seek to be valued by the communities where we are working...As any industry we have our problems every now and again; therefore, it is important to have the community's support during difficult moments. [Bruce Turner, Escondida's CEO, October 2003].

²⁹No particular order.

Among the main challenges that this case reveals are the following:

- **For SMEs:** large companies, such as Escondida, are in the process of rationalising contractors and suppliers. They have experienced that it is hardly manageable to have numerous suppliers (almost 2,000 in this case). In the Chilean mining sector, the most likely supportive strategy for SMEs will be to increasingly become more professional, assuring high levels of quality, timely service, environmental performance, etc.; and they will have to specialise in services (rather than in, for example, spare parts). Additionally, suppliers installed at the mine site will necessarily have to become bigger; otherwise it will be difficult for them to respond to the company's demands.
- **For the public sector:** as one of the interviewees stated, "the public agencies are quite behind in environmental issues. The state has not prepared itself to protect the environment. One example: we do not know where to send our wastes so that they be properly disposed" [Patricio Mora, SALFA's general manager, October 2003].
- **For the large company:** to be able to communicate timely, clearly and effectively. As the environmental affairs manager admitted, communication is a big challenge, particularly in a company the size of Escondida. In general, they have taken the strategy of convincing with concrete results, when the actions are finished. This approach has both advantages and disadvantages. For internal purposes it might be enough, but outside the company it might cause a number of misunderstandings.

Some of the recommendations that were suggested by the interviewees include:

- **SMEs** should be very persistent when embarking on certification processes. Sometimes it is hard to keep the pace, particularly when there are a number of other issues to be faced and personnel and resources are scarce.
- In the context of an associative project like this, it proves crucial to build constructive relationships between those involved.
- To rely on experienced consultants.
- The leading company should design and implement a broad internal and external communication programme.
- The concept of governmental funds administrated by independent operators is appropriate but it is necessary to have a number of operators that can guarantee a healthy level of competitiveness.

*Weaknesses*³⁰

- Poor capacity and awareness of environmental issues among employees.
- Certification and auditing costs to extend the certificate.
- It would be better to have more CORFO operators in the region (in order to promote more competitiveness).
- There are few consultants based in the region who have practical experience.
 - CORFO bureaucracy might require too much time and resources.
 - PREPROFO was longer than necessary.
 - The delay and uncertainty regarding administrative issues probably contributed to the withdrawal of three enterprises.

³⁰No particular order.

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Business opportunities for small suppliers – Pão de Açúcar Group and their “Caras do Brasil” programme

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Case Abstract

THE PÃO DE AÇÚCAR GROUP is the largest Brazilian supermarket chain, holding a 15% share of a very pulverised market characterised by small players (2002). The *Caras do Brasil* Programme (*Faces of Brazil*) was created in late 2002, aiming to develop a new sales channel for sustainable handling of products. The programme opens opportunities for small suppliers not only in the Pão de Açúcar chain, but also among competitors and other industries. The programme established requirements for producers to become suppliers, aiming to adapt products to a regular commercialisation with the group. This way, small producers can now rely on a complete business process, while beforehand the goods were sold mostly through small channels.

According to a survey held by the Brazilian Ministry of Environment and IBGE – Instituto Brasileiro de Geografia e Estatística (Brazilian Institute of Geography and Statistics) – the role of conscious consumers is representative. In 2001 44% of consumers bought products in recyclable packages, 36% preferred environmentally friendly products, 81% indicated motivation to buy ecologically responsible products and 73% claimed motivation to buy an organic product. These numbers show that some Brazilian consumers consider buying sustainable products as a way to engage with social, environmental and sustainable development responsibility.

Background

Brazil can offer an enormous variety of natural and sustainable products that would add social and environmental value. Usually the characteristics of the producers of such goods are small, poorly professional, with little experience in negotiation and administration and hardly any commercialisation to large retailers. They are micro-firms, associations, cooperatives or NGOs that bring direct or indirect benefits to low-income people, most of whom have low expectations about knowledge, involvement and professional improvement. Their competitive advantage is the extraordinary skills and experience in the handcrafts made. The peculiarities and needs of such producers generated the social concern and commitment of Pão de Açúcar before creating the *Caras do Brasil* Programme.

The Pão de Açúcar group

The Pão de Açúcar is a family-owned group that started in 1948 with the *Doceria Pão de Açúcar* (sweet bakery store) in São Paulo. In 1959 the first supermarket was opened, next to the *Doceria*. Acquisitions since then have made the group the largest employer in the country, with 58,000 employees working in 500 stores in 12 federal states. It is composed of four different companies: *Pão de Açúcar* and *Barateiro* (supermarkets), *Extra* (hypermarkets) and *Extra Eletro* (electrical household goods), each one with specific strategic focus and consumer profiles. The first store abroad was opened in Luanda, Angola, characterising the Pão de Açúcar chain as a multinational group, with headquarters in Brazil. Its most important competitor is the French Carrefour.

Nowadays, the Pão de Açúcar Group is the largest Brazilian supermarket chain, holding a 15% market share in 2002 in a very pulverised market characterised by small players and few chains. The group has shown extraordinary growth, not only because of its sales performance but also due to the continuous acquisitions made throughout the country in the last years. One of the group's growth objectives for the next five years is an increase of about 15% in sales area (m²).³¹

³¹ www.paozacucar.com.br

The *Caras do Brasil* programme

The Pão de Açúcar Group has gained its reputation not only through its economic power but also through its social initiatives. They established an Institute to provide educational qualification and community relations, which supports thousands of youngsters. Independently of the institute, the group sponsors sports and music events. Its latest initiative was to create recycling stations in 20 stores. In the company they say that social responsibility is in the Pão de Açúcar DNA.

Looking for typical Brazilian products that would potentially be accepted by the international market and exported through its ExportaPão trading division, the Pão de Açúcar Group decided to expand its portfolio. At this time the opportunity was to reach Brazilian suppliers whose typical sustainable products presented characteristics of social and environmental added value, ready to respond to conscious consumers' expectations.

Supported by the president, the board and the directors, the Pão de Açúcar Group created the *Caras do Brasil* programme in September 2002, aiming to open a sales channel for suppliers with good production know-how but less familiar with commercialisation processes and unable to reach larger sales channels.

In December 2002 the programme promoted an exhibit of 400 sustainable products offered by 15 potential suppliers. The objective of this event was to launch the programme and to advertise its dimensions and intentions to the media and the employees. Mrs. Ana Maria Diniz, a granddaughter of the founder and one of the programme's most supportive players, publicly announced its importance. Augusto Cruz, chairman of the group, and Mr. Hugo Bethlem, executive commercial director, also attended the event, indicating that the programme had high priority among key decision makers within the group.

The programme key players were defined: Mrs. Beatriz Queiroz, Manager of Special Products and the person in charge of the programme; Mrs. Sueli Renberg, the Ombudsman for Suppliers; Ms. Joana Fernandes, Programme Assistant; and Mr. José Pasowitch, independent external consultant.

In January 2003 the *Caras do Brasil* website was online.³² One of the first activities was to facilitate the applications of potential suppliers through the

The Caras do Brasil programme aims to open a sales channel for suppliers with good production know-how but less familiar with commercialisation processes and unable to reach larger sales channels.

³² www.carasdobrasil.com.br.

internet or a zero-cost telephone line. One of the requirements to participate in the programme is that the chosen products should individually cost less than fifty Reais (17 US\$). This way, the final price would be affordable to consumers in retail channels such as supermarkets. Such products include: groceries, perishables (holdable for more than five days, enough for delivery to the stores), personal hygiene, decoration, cookery utilities and textiles.

In line with government rules, minimum requirements were put to the suppliers interested in joining so as to adapt their conditions to a channel opened to large volumes of sales and businesses. Pão de Açúcar's employees, deeply involved with the programme, dedicated themselves seriously and helped the suppliers to meet the requirements. This meant a radical change in their routine. This support was essential to guarantee the programme's credibility. A specific team called *Equipe Caras do Brasil* was established to deal with the programme suppliers, who showed very different characteristics. A special training was internally offered to start using unit picking procedures, a system since abandoned for large retail channels.

The potential suppliers had to develop competences to adapt to commercialisation: to establish a formalised legal entity able to invoice with value-added tax; to comply with national and local laws and with international treaties and agreements; to introduce bar codes in their products; to maintain trustworthiness in fulfilling contracts; to assure that the increase in production capacity does not reduce sustainability aspects; to be agile and creative in solving problems and challenges; to be responsible for fragility of products and eventual difficulties with transportation; and to respect the date and time to deliver the products, making sure that they are correctly received by the Pão de Açúcar distribution centre.

Eighty suppliers and 800 products were registered in August 2003. Thirty-four suppliers were selected to launch their products in four privileged pilot stores of the Pão-de Açúcar chain in São Paulo. Special spaces were set aside to offer these products in such a way that consumers could identify and characterise them as special, independently of their category.

Application of the Global Compact principles and benefits to the programme

The Pão de Açúcar Group considers the *Caras do Brasil* programme a business opportunity, not a social responsibility programme, despite the positive social impact generated. Therefore the programme follows Global Compact principles as consequence of their actions.

Sustainability and responsibility

The *Caras do Brasil* suppliers can only be accepted and registered in the programme if they fulfil the requirements established in contract:

- respect for the rights of local communities to use the land in the long run, i.e. that any company active in a community should respect the environment in such way that the community can use the environment even long after the business has ended (this is especially relevant to agriculture, mining, logging, cement factories, etc.);
- control the use of pesticides, chemical agents, erosion, hydric resources, sustainable harvest and conservation of high-value areas.

These requirements guarantee benefits of image for the programme and satisfy consumers that are becoming more environmentally aware and responsible. In order to be included in the *Caras do Brasil* programme, suppliers have to avoid child labour, as stated in the Global Compact Principle 5. Also, they agree with the Principles 1 and 2, protecting international human rights within their sphere of influence, making sure that their own organisations are not complicit in human right abuses. In this sense, they follow the norms related to the workers’ health and safety, respect indigenous rights and assure real representation of/in the community. In other words, the company behaves in such way that it somehow represents the community and the community’s interests itself, rather than imposing its actions upon the community.

In reality, results of the *Caras do Brasil* programme go beyond the support and respect to human rights, in the sense that it encourages the sustainable growth and development of suppliers and communities. The requirements imposed for new suppliers help them to create more professional mechanisms and enable them to deal with the retail market without needing continuous assistance. The programme goal is to see the suppliers starting a process of self-management, with ability to commercialise with any sales channel, once they have know-how and their own resources to do so. The programme leaders understand that its social role has been accomplished as it helps suppliers to generate economic resources in a sustainable way.

According to Mrs. Beatriz Queiroz, the programme manager, Pão de Açúcar’s directors believe that the suppliers effectively follow the Global Compact principles of human rights and social and environmental responsibility, as most of them were indicated or supported by governmental projects

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or by non-governmental organisations. The *Caras do Brasil* is a very young programme (four months of operation) and has intensely worked on several fronts to ensure successful outcomes. The idea is to capacitate the suppliers and to offer feedback, keeping them motivated but also realistic. The programme leaders have not yet been able to establish a monitoring system, but developed a checklist model to use in the near future. They do plan to monitor the suppliers' responsible procedures by visits of programme representatives or independent consultants.

The *Caras do Brasil* is committed and makes efforts to maintain each supplier's cultural characteristics and local traditions, respecting its routine and production limits. For this reason, the sustainable aspects have always been considered. There has been no interference in the suppliers' production capacity or price fixing. The criteria established by the programme leaders aim to maintain the commercial viability, the identity of the accepted products and their sustainable characteristics which give them high added value and guarantee their differentiation, meeting the conscious consumer's expectations. Thus, besides improving the image of the Pão de Açúcar Group, the development of this new business may respond to consumers' expectations and awareness, making them more satisfied and faithful clients.

Benefits and difficulties

On behalf of the Pão de Açúcar Group, Mr. Hugo Bethlem, Executive Commercial Director, Mrs. Beatriz Queiroz, Programme Manager and Mr. José Pasowitch, consultant for the programme, state that the possibility of assuring a continuous income has other effects on the social life of the suppliers. Their expectation is that the quality of life will be improved, creating social inclusion, more environmental awareness, higher self-esteem, exit out of the informal market, recognition and valuation of work developed while maintaining their traditions and culture.

As an example, a supplier from the northeast of Brazil – considered one of the poorest areas in the country – could not hide her joy in receiving the first payment for the products she sold to *Caras do Brasil*: *With this amount, I was able to pay for the first instalment of the portable little radio I had always dreamt about ...* Another supplier said frankly: *The first payment I received allowed me to buy furniture for my house!*

Providing capacity for commercialisation was a rewarding task for Pão de Açúcar employees as a whole. A top manager emphasised the importance of the *Caras do Brasil* programme for the Pão de Açúcar Group, comparing it to the Fome Zero programme (*Zero Hunger* – a programme developed to reduce hunger and malnutrition) of the Brazilian government. The new sales channel created for these producers also allows more circulation of their products in the Brazilian markets, linking with the dissemination of regional cultural aspects within the country and efforts to reactivate the internal commerce of typically Brazilian products.

On the other hand, the size and location of most suppliers, their type of organisation and lack of business know-how has still meant difficulties for both sides. Large distances and transportation structure do not make for ideal logistics: packing may not be adequate, the costs increase and the delivery system may not be reliable.

The *Caras do Brasil* leaders have a perfect understanding of the scale of the problem caused by the high cost of transportation and are trying to find the best way, either helping the products to be sold sooner through local actions, or looking for new forms of advertising and communication to consumers.

The special internal logistics and stock costs, as well as high taxes to be paid by the retailer, are transferred to the consumer, increasing the final price of the products in the supermarket shelves. As the products come in distinct forms of packing, mostly fragile and in small volume, automatic procedures are not always applicable. Some products are even delivered by normal postal services.

The products have not been sold as fast as other traditional supermarket items and this creates additional costs. While for some *Caras do Brasil* products the Pão de Açúcar leaders decide to forego a profit margin, in other cases the final price to consumers may be more than double what was paid to the supplier.

With the aim to respect human rights, the programme leaders do not interfere in volume and price setting by the suppliers. But they do at times notice the lack of technical capacity of the suppliers to determine the optimal value of the products. According to the Pão de Açúcar managers,

The Baniwa Indians produce baskets to sell to *Caras do Brasil*. The production task is divided in groups of handcrafters, defining the deadline for delivery. The baskets leave the Amazonas area, on the frontier with Colombia, by bongo canoes (excavated tree trunks covered with liana and fitted with a rear engine). Each canoe can carry 100 large baskets and picks them up from the banks along the 400 kilometres of the Içana River in two to four days. Because of 19 waterfalls, the baskets are offloaded on to four-wheel vehicles for a 30-kilometre run. Then a regular boat goes 900 kilometres on the Negro River and takes the baskets to Manaus (about 4,000 km from São Paulo), where a truck is waiting to carry them to Belém (almost 3,000 km from São Paulo), where they are reloaded on a ferryboat. From there, a truck takes regular roads to Brasília and finally to the Pão de Açúcar distribution centre in São Paulo.³¹ The suppliers are responsible for all these product transportation costs.

³¹ www.ecosdaterra.com.br and Guia Rodoviário do Brasil – Quatro Rodas. São Paulo: Editora Abril, 1976

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occasionally suppliers overestimate the product price to the programme, which makes it unaffordable to consumers. If the product in the shelf is not sold, there will be no extra income generation for suppliers. The programme leaders are trying to discuss the final price structure, as many suppliers seem reluctant to accept significant differences. The taxation on the products is usually higher than 35%, which is passed on to consumers in the final price. There is pride that the *Caras do Brasil* is a proper business programme, not just an added-on social responsibility project. The goal is to include small suppliers into Pão de Açúcar's portfolio, opening to them a channel that can bring good results in a professional way. Hence the social responsibility is a consequence, not a driver, of the programme. Suppliers' professionalism is the keyword for the programme leaders.

Suppliers

The potential suppliers got to know the *Caras do Brasil* programme through television, newspapers, supportive institutions, producers' partnerships or cooperatives. Some suppliers were invited to apply, with the help of Mr. José Pasowitch, an independent consultant for the programme, whose role was essential. In December 2003 the *Caras do Brasil* programme established business relations with 34 suppliers.

The authors of this case elaborated a survey to obtain information from and about them, either through a questionnaire sent by e-mail or by telephone calls and visits. Twenty-two suppliers responded. Apparently all correctly understood and defined the programme. A supplier said:

In our perspective, it is a serious programme, with not only profit but also social interests. Its objective is mainly to benefit needy communities, opening to them a very important space in the market, to which their products would not have access for many reasons, including the difficulties of distance and impossibility to become known.

Working to protect economic livelihood of local communities is the idea mostly related to the *Caras do Brasil* programme, in the sense that the programme provides suppliers' capacity for the market, enabling income generation in a self-sustainable way.

Most suppliers expect an increase of sales through the *Caras do Brasil* programme. Nevertheless, a few suppliers may be expecting more social

responsibility than “simple” business actions focussing on short-term results. When asked about their understanding about the programme, some of their answers were:

- It is a Pão de Açúcar programme created to tackle their concerns with environmental and social problems.
- It is strong and determined action by the Pão de Açúcar Group to assume its environmental and social responsibility that positions the group in the vanguard of the large corporations.
- The proposal to participate in the programme was social responsibility. It is now confusing us.

For suppliers who were not legal entities, a first difficulty was to solve this situation. Others mentioned lack of experience, such as the use of bar codes and the product package adaptation and standardisation. On the other hand, they all agreed that these requirements are necessary to become part of a profitable sales channel, expressing their feelings as *satisfaction, trust, recognition, safety, pride, optimism, opportunity of an increasing future for business and perspective of complementing the participants' family income.*

As earlier mentioned, the transportation cost (covered by the suppliers), taxation and mark-up are apparently making the product very expensive for consumers. In this regard, a few suppliers mentioned that the programme leaders had suggested a price reduction when selling to Pão de Açúcar, to also try to reduce the final price to consumers. Some suppliers' comments were:

- The income from Pão de Açúcar invoices has only covered my transportation costs.
- A sustainable product is expensive. If this is not told to consumers, how can they make their choices?
- Delivering few units costs us more than the products themselves.

Concerning the *product-producer-environment* integration and the supplier-retailer-consumer chain, the suppliers feel that the consumers should know better the differentiation of the *Caras do Brasil* products and expect more support from the four stores in the programme during this launching period. Given that the programme is still new, the suppliers believe that many consumers are not automatically attracted to the designated shelves. The producers insist that the motivation for consumers should be

The producers insist that the motivation for consumers should be stressed with the sustainability approach (not charity), through more local marketing and advertising by Pão de Açúcar.

stressed with the sustainability approach (not charity), through more local marketing and advertising by Pão de Açúcar.

The authors of this case noticed that the sustainability approach was clearly explained in the programme folder and in small tags attached to many products. This material is expensive, as it is printed in colour on recycled paper. These information materials were offered during the launching period of the *Caras do Brasil* programme, but it is somehow understandable that this marketing strategy is not feasible in the long term. The suppliers themselves are, of course, free to add any information to the products, but apparently most of them cannot do so because of the additional cost involved.

Most suppliers confirmed that there is no child labour in their activities.³⁴ Only one stated that some producer families rely on 12-year-old children to make baskets, considering that this is legal. The *Caras do Brasil* programme has done its best to maintain the application of the Global Compact Principle 5. The confirmation of effective abolition of child labour will only be possible through monitoring. Frequent visits would be excessively time-consuming and costly.

The suppliers seemed to be aware of the programme's requirement of sustainable production, acting according to the Global Compact Principle 7, Support precautionary approach to environmental challenges and Principle 8, Undertake initiatives to promote greater environmental responsibility. Many affirmed that the environmental responsibility is one of the most important objectives of their organisations. A statement was:

We are partners of the INPA – Instituto de Pesquisas da Amazônia (Research Institute of the Amazon), developing research on sustainability and responsible handling of the plant species used in the production of the baskets.

Many suppliers also established partnership with the Brazilian government, non-governmental organisations and other institutions oriented to labour capacity building, environmental preservation and sustainable development.

³⁴ In Brazil the minimum age allowed for children to work as apprentices is 14.

Partnership

Several partners have contributed substantially to the development of the producers, helping them to fulfil the requirements demanded by the market. Even having no formal agreement with the programme, SEBRAE (Serviço de Apoio às Micro Empresas de São Paulo), for instance, offered courses, training and financing to some projects, aiming to build the capacity of producers. Others helped to elaborate a business plan and supported producers with credit and resources, with the aim to develop the whole productive chain. Their intention was to make the producers more professional and ready to create an additional self-sustainable income, as states the Global Compact Principle 1: *Businesses should support and respect the protection of internationally proclaimed human rights within their sphere of influence, e.g. by working to protect the economic livelihood of local communities.*

The partnership of all suppliers with other institutions is seen by the *Caras do Brasil* programme as a guarantee of their social responsibility and as a certification of sustainability. Nevertheless, Pão de Açúcar's control and effective guarantee of the environmentally responsible handling and production will only be possible in the future. Some suppliers affirm to have certification, but fail to indicate from what institution, which suggests that the information might not be totally correct. Several assure that they frequently receive fiscal agents to verify the handling and production, thus confirming their sustainable products. Although there is a governmental requirement, a seal or sign of this certification seems to be missing in several product packages.

An objective of the Ministry of Environment is to offer know-how to some initiatives of small suppliers, making their business sustainable and providing adjustments in the current commercialisation process. Governmental agents of the ministry try to support strategies to reduce production cost and increase quality, so that products have more value added and become more competitive. The Sustainable Business Project was created to support initiatives developed by non-governmental organisations, cooperatives, associations and international governmental agencies interested in offering credit to these suppliers through commercial, economic and administrative assistance. Considering this endeavour, the *Caras do Brasil* programme leaders made a proposal of partnership with the Ministry of Environment, which is being negotiated.

UNDP also supports initiatives of some small suppliers committed to sustainable handling and production in Serrado and Mata Atlântica, two large areas in Brazil. Some of the companies participating in the UNDP project would actually fulfil the conditions to become a supplier within the *Caras do Brasil* programme. According to UNDP representatives, one of the difficulties in accomplishing a short-term development is the suppliers' slowness in adapting to the different economic and managerial reality of large retailers as the Pão de Açúcar Group.

Consumers

The authors of this case interviewed 66 consumers in three of the Pão de Açúcar supermarkets where the *Caras do Brasil* is installed. The purpose was to hear their opinions about the creation, development and actions of the programme. Unexpectedly, despite the privileged location of the shelves, very few consumers effectively knew the programme or had bought products, nor were they ready to pay more to support the suppliers. Some consumers explained that they usually go through the stores so fast that they pay no attention to goods not on their list. Others mentioned that these products are not appropriate for a supermarket or a grocery store. Several of the consumers had seen the products but had not paid enough attention. When they heard about the origin of the products, all consumers became very interested and stopped for a while in front of the shelves, holding and reading many packages. After careful observation, 19 of them demonstrated intention to buy, despite the high price, describing the reason either as ethics or as social:

- The product has something special, that it is different than the average.
- The product is beautiful!
- It is craftsmanship!
- It is Brazilian!
- It has quality!
- It is natural!
- The product attributes add value to it.
- It gives suppliers additional income.
- It is ecologically responsible.

The consumers expressed very positive opinions about the *Caras do Brasil* as a programme. Some of their comments were:

- It is wonderful!
- It is the inclusion of small communities ... it is very important that they get to the consumer!

These statements, as well as the purchase intention, confirm the importance of the Global Compact Principles 1 and 2, in regard to human rights and the perspective of *working to protect economic livelihood of local communities*. The consumer notices the Pão de Açúcar Group's intention of creating a sales channel for small suppliers as a way to encourage the commercialisation of their products and generating sustainable income and practising social responsibility. Consumers mentioned environmental concern as something that set the product apart and added to its value, but not as their primary purchase motivation.

Considering the social, economic and political difficulties that Brazil has suffered for many years, it is interesting to see how the cultural impact interferes in the objectivity of the consumers' analysis about the final prices and about the *Caras do Brasil* programme itself. A few of the 66 consumers interviewed agreed with the price and paid for the products, meaning to support the supplier organisations. Some do not understand and feel that Pão de Açúcar might be exploiting such communities. Others find the *Caras do Brasil* programme fantastic but just can't afford the high prices.

Most of Pão de Açúcar's consumers believe in its practices and social and environmental responsibility guaranteed in its products. This indicates that consumers tend to look for the social benefits of the *Caras do Brasil* programme products, besides their ethical or useful aspect.

Results

It is not easy to evaluate such a new programme. After four months of operation, the authors venture to state that it can be a very successful initiative if all players dedicate a generous dose of effort to make it happen.

Programme

Despite the difficulties of communication and the short period of the programme operation, some suppliers' information seems to indicate impact on a social indicator. It is the number of people directly or indirectly involved in the programme, as participants of the production or commercialisation of

A supplier's comment summarises their perception:

"Many changes happened in our commerce, including the organisation, packaging, delivering. We were forced to create a selling structure a thousand times better than the one we had. Besides, our craftsmen felt significantly encouraged to know that their work was recognised in a large sales centre."

the goods sold to Pão de Açúcar. They come from 143 communities from 16 Brazilian states, represented by 24 of the 32 current suppliers, with direct impact on 3,900 people (34% male, 66% female) and indirect impact on more than 17,000 people.³⁵

The *Caras do Brasil* products represent an average of 0.32% of the sales in the four stores. In total, about 10,000 items were sold and the average price was about 13½ Reais, an amount considered reasonable for a super-market.

Some products were exported to Martinique in the first Trading ExportaPão test operation for the programme. This may be the beginning of the international commercialisation of the *Caras do Brasil* products.³⁶

Suppliers

The producers' feeling and the perspective of a sustainable additional income may benefit either eight people or as many as 9,000 people, depending on the supplier. Some suppliers experienced more visibility for their products after entering the *Caras do Brasil* programme. This generated more sales channels and more income. A supplier estimated his increase in sales at 40% percent; another at 70% and a third even claimed an increase of 300%. As discussed before and due to the rather short period of existence of the programme, most suppliers are still expecting an increase in sales, advertising and income.

Employees

The creation of the *Caras do Brasil* programme was perceived by some employees as related to the new element included in the Mission and Vision of the Pão de Açúcar Group, which stresses the intention of offering a contribution to the *nation's development and the social responsibility*. The support from the owners, the board, the directors and the highest-level managers added credibility and professionalism to the programme, motivating all employees. The programme has gained internal visibility since it was presented to the Executive Committee and the group founder attended the internal programme launching ceremony.

The Human Resources Department provided banners and posters for display at conspicuous company locations, such as elevators and lobby.

³⁵Caras do Brasil program.

³⁶Caras do Brasil program.

For a senior Pão de Açúcar manager, the great advantage of the *Caras do Brasil* programme is not its *non-social-work* approach but its sustainable character. The manager of a store located in a nice neighbourhood of São Paulo expressed keenness to have the programme in her store. *All my clients already know about the programme, I can hardly wait to see the products in the shelves!*

Perspectives and trends

The good perspectives for the *Caras do Brasil* programme are related to its expansion in the Brazilian market and to more stores of the Pão de Açúcar Group. The decentralisation of the distribution centre may solve some of the difficulties found in the logistics and transportation costs, which could attract new suppliers and different products.

According to Mr. Hugo Bethlem, Executive Commercial Director, concrete plans are being developed. Some actions could be special media and store promotion. A creative way to find solutions for some of the difficulties the programme faces in these first months of operation is the initiative of offering an award to the best packaging proposal presented by students and professionals in key areas.

Two aspects will contribute to the sustainability of the programme: on the one hand, *Caras do Brasil* staff have developed a follow-up checklist to be used as an information system for the short term; on the other hand, *Caras do Brasil* has established a partnership with UNDP and the Ministry of Environment that will assure the necessary means, including financial, to achieve the objectives of the programme in line with several Global Compact principles.

The programme success depends a great deal on the store managers and the employees handling the products directly. The distribution centre has been proactive, which is crucial to the sustainability of the programme.

The suppliers are eager to see the programme expand and are mostly proactive in professionally overcoming their limitations, adapting themselves to the market requirements. Ms. Joana Fernandes has invested a great deal of effort in order to assure that suppliers are satisfied, providing the demanded information.

Throughout the world citizens are becoming more and more aware of their social and environmental responsibilities. As consumers they tend

to be proactive in relation to sustainable products and projects that can generate additional income for needy communities. In Brazil they usually respond very positively to clear and constructive communication.

Final considerations

The *Caras do Brasil* programme leaders insist that social and environmental responsibility comes as a consequence, while the goal is sustainable business. The proactive attitude noticed in the interviews with consumers, employees and suppliers showed that the perception of the programme nevertheless is its social and environmental aspects. This is not negative. The necessity of offering new and differentiated products to the clients, of looking for business alternatives and of adding value to the corporative image, as well as pursuing actions that promote sustainability, is becoming more and more part of the organisational DNA, part of its values and mission.

The *Caras do Brasil* programme supports the Principles of the Global Compact, related to human and workers' rights and environmental responsibility. The opportunity of commercialising sustainable products that bring as the main differentiation the social and environmental added value, makes the programme responsible for actions oriented to maintaining, respecting and encouraging social and environmentally responsible attitudes.

Promoting business linkages in the automotive component sector: Experiences of UNIDO working with Renata Engineering and Metalman Auto in India

April 2004

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*It is essential
that there is
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Executive summary

PRIVATE ENTERPRISE HAS BECOME widely recognised in driving economic and social development. Multilateral and bilateral development cooperation agencies are beginning to regard the business community as an increasingly valuable partner in pursuing development-oriented activities.

This emphasis on business cooperation and linkages and the persisting imbalances between nations in their capacity to benefit from the globalisation process have significant implications for the support requirements of small and medium enterprises (SMEs) in developing countries. SMEs are often excluded from global value chains because of their lower capacity to meet quality and conformity requirements and to implement the required social responsibility initiatives that many large transnational companies (TNCs) have been adopting. Therefore, it is necessary to support these SMEs through programmes that help them to create business linkages with larger firms and thus become integrated in the international supply chain of goods and services.

In order to create business linkages between SMEs and larger firms, it is essential that there is a transfer of know-how that will contribute to the upgrading of SMEs and the consequent economically, socially and environmentally sustainable development of poor countries. For that purpose, UNIDO has implemented a Business Linkages programme that focuses on quality improvements, productivity enhancement and the international competitiveness of SMEs in developing countries. The programme aims at strengthening cooperation among development actors and it is based on partnerships that involve stakeholders from various sectors.

One of the cases where the UNIDO Business Linkages programme has been applied is in the automotive component industry in India. Highly fragmented and with a very small scale of operation when compared to the global market, this sector has been facing various challenges that threaten its sustainability.

First, trade liberalisation and opening of markets have increased the level of global competition with growing challenges for companies to survive.

Second, assemblers and car manufacturers are increasing their requirements and demands on suppliers in the areas of quality, cost and delivery. Furthermore, a process of consolidating suppliers and 'tailoring' supplies into the car production system has threatened a large number of SMEs.

In addition, customers and civil society groups are requiring companies to incorporate socially responsible practices and report on their environmental impacts. As proved in the case studies presented, managing social and environmental aspects properly can represent good opportunities for Indian SMEs by achieving positive productive outputs.

Finally, there has been an increasing pressure for suppliers of automotive components to upgrade technologically and to incorporate a very flexible production system, capable of adapting to the transforming needs of the assemblers.

All these pressures have forced SMEs in the Indian automotive sector to change their way of working and adapt to the new requirements of the market in terms of international standards, higher quality and delivery targets.

UNIDO has supported these companies through a business linkage initiative that has included two programmes so far:

Programme 1, initiated in 1999, lasted six months and was concentrated on the western part of India. Its main objective was to provide 21 SMEs in the Indian automotive component sector with technical assistance delivered by a multidisciplinary team of experts. Some of the activities included in the programme were class room training sessions on quality management, cost efficiency and delivery, visits from industry experts to overview the production process and provide recommendations based on international best practices and selection of some SMEs to exhibit at the auto fair in France based on best performance criteria.

Programme 2 started in February 2003 and it will last 30 months. It initially includes 40 companies from four different regions of India. Based on the lessons learned from the first phase, this programme continues to deliver technical assistance to companies to meet the challenges brought by current Indian market conditions. Furthermore, the programme provides training to Indian engineers so as to build up a pool of local expertise to carry the activities forward and make the programme sustainable – anchored institutionally in the Automotive Component Manufacturers Association of India.

This report has analysed two case studies based on the examples of Renata Engineering Plastics – a company included in Programme 1 – and Metalman Auto, a company participating in Programme 2. Its conclusions

Consolidating suppliers and 'tailoring' supplies into the car production system has threatened a large number of SMEs.

Through its participation in Programme 1, Renata Engineering Plastics, a local manufacturer of plastic components, has achieved outstanding results in a period of four years:

- Business performance – the company has increased revenues by 150%, productivity by 300%, and has reduced production costs by 40%.
- Quality performance – customer complaints have dropped by 75%, the product defect rate by 68% and the percentage of capacity loss by 35%. In addition, there has been an improvement in other indicators such as on-time delivery (20%), rate of rejects (40%) and changeover time (50%).
- Environmental and social performance – there has been a significant reduction in energy consumption per tonne produced and Renata has invested in environment-friendly technologies and water recycling. While the company has achieved zero accidents with employees in 2002, it has also started to quantify indicators that measure employee satisfaction and intends to invest 125 hours a year per employee in external training.

In addition, as a result of its participation in the Business Linkages programme, the management of Renata has understood the importance of the Global Compact principles for improving business performance and contributing to social development. In November 2003 the company signed a letter agreeing to commit to the principles of the Global Compact in respect to human rights, labour rights and environment protection. Renata's management is committed to integrate the same principles into their strategy as well as to transmit them to their employees, partners, clients and the public.

Having joined Programme 2 in February 2003, Metalman, a producer of chassis and accessories for the automotive industry, has achieved substantial improvements in its performance in a very short period:

- Business performance – the company has increased its level of sales revenues and gross margins. In addition, since February 2003 productivity has increased by 18% while the value added per employee has increased by 150%.
- Quality performance – there has been a dramatic reduction of 91% in the number of defects, which has achieved minimum levels in the most recent months. In addition, there has been a reduction of 28% in the tool change time and customer complaints were reduced to only one complaint per month, a reduction of 85%.
- Environmental and social performance – there have been substantial savings in the use of energy and natural resources: 24,000 litres per month in water and 260 units per month in electricity. The number of accidents involving employees has been rapidly reduced to practically zero and absenteeism among employees has also been reduced considerably by more than 50%.

The management of Metalman has also demonstrated its awareness of the importance of the Global Compact objectives. In November 2003 the company joined the Global Compact as a participant through signing its letter of commitment to the nine principles, thus showing its willingness to further integrate the same principles into its strategy and business practices.

reflect how technical assistance and partnerships oriented to strengthening business linkages improve quality performance and enhance SME competitiveness.

Furthermore, the consideration of the Global Compact labour principles and the activities undertaken to embrace the Global Compact environmental principles have created on the one hand a better working environment, reduced labour turnover and increased employee productivity, and on the other hand reduced energy and water consumption, as well as waste generation, directly impacting on cost reduction and profitability.

The results obtained in both cases demonstrate the success of UNIDO's Business Linkages programme in supporting SMEs to face the challenges and meet the requirements of a changing market scenario. The initial emphasis on productivity enhancement and quality upgrading has produced tangible impacts and incentives, as seen in the substantial improvements in the indicators of business and quality performance for both companies.

Based on these results, there are increasing prospects for the companies to broaden their horizon by achieving further results in terms of social and environment performance. Their awareness and eagerness to become partners in the Global Compact are important steps for their further action in this area.

Finally, most important of all, as a result of all these initiatives the companies have been able to create business linkages in the local market and have increased the prospect for linkages in the global supply chain as a result of their exposure to international best practices.

In conclusion, it has been seen that the demonstration of business benefits from a partnership programme can widen the horizon of SME managers and make them more responsive to a broader agenda addressing also environmental and social concerns.

This is among the key lessons learnt in the UNIDO programme: a commitment to applying environmentally friendly processes, a commitment to waste minimisation, a commitment to reducing work-related accidents, a commitment to enlightened human resource development e.g. through more emphasis on training, in essence a commitment to improving the impact of business on workers and on the environment as a result of instilling a longer-term perspective and vision and of developing a strong SME business case.

At the outset of UNIDO's programme in India, the participating SMEs were unaware of the UN Global Compact and its significance for them. Meanwhile, several of them see clear merits in positioning themselves as responsible companies and good corporate citizens. Thus, while a CSR agenda was clearly not the initial trigger and driver of their involvement, it has resulted from their learning process.

For UNIDO this business linkage programme has provided important insights and helped it to learn and develop some indispensable elements of partnerships with the private sector. First and foremost these include: the importance of creating local ownership and commitment; the need to listen to and respect the views of each partner; the definition of common goals, objectives and targets; a commitment towards continuous improvement; and the rationale of a gradual and cautious approach towards instilling a culture of responsible entrepreneurship in SMEs.

CASE STUDY: RENATA ENGINEERING PLASTICS

Description of the company

Background

Renata Engineering Plastics commenced operations in September 1992. The CEO, Mr. Rohit Thawani, is a mechanical engineer, a graduate of the Delhi Engineering School, and has professional experience with Indian-based multinationals such as DCM Toyota, Modi Xerox and Klochner Windsor.

Renata's first clients were Amphenol Amphetonix and Lumax. Since then the company has been growing steadily, developing more than 60 different types of plastic components and moving upscale in the production of higher added-value materials. It currently employs 20 people.

At present Renata is engaged in the manufacture of custom-moulded plastic components. The components are supplied to a variety of industries that include automotive parts, consumer durables, electronics, telecommunications and engineering.

Participating in the business linkage programme

When Mr. Thawani decided to start a new company in auto components, he was convinced he would be trying to sell to the global market. As he likes to say: *"The market is the whole world now."*

Local markets, especially in the automotive component sector, are regionally concentrated, with three major geographical areas, Delhi, Mumbai and Chennai. But international markets are structured differently and accessing them does not depend on geographical location but on providing comparative advantage, quality and effectiveness in the services provided.

"If India has become a world leader in software production," says Mr. Thawani, "why can't we become world leaders as suppliers for the automotive sector? We have the potential skills, the comparative advantage and the technical and commercial assets needed to provide good global services. What we need is the capital to be able to upgrade technologically and the awareness to create a continuous learning approach to our production systems."

*"The market
is the whole
world
now."*

Mr. Rohit Thawani
Renata Engineering Plastics
CEO

*By upgrading
its technology
Renata has
achieved
several positive
results
related to the
environment.*

Hence his major concern for keeping his business competitive was how to upgrade technologically. In 1998 he received a letter inviting him to apply to a Business Linkage programme that was being implemented by UNIDO in India to upgrade SMEs of the automotive component industry.

The programme selected 21 SMEs from the automotive component sector. The group represented a broad variety of materials (metal, plastics, etc.) from the western Indian region. The programme consisted of three different types of activities:

- Classroom training sessions with the selected SMEs to brief them on quality management, cost efficiency and deliveries;
- visits from industry experts to oversee the production process and make recommendations to improve them, as well as providing information on practices in China, Europe and Japan;
- of the 21 SMEs six were selected based on best performance to travel to the *auto fair of France* in 1999 and gain exposure to the production processes of European manufacturers.

Outcome and proven results

In order to evaluate corporate performance and measure qualitative and quantitative impacts, three different areas of performance need to be distinguished:

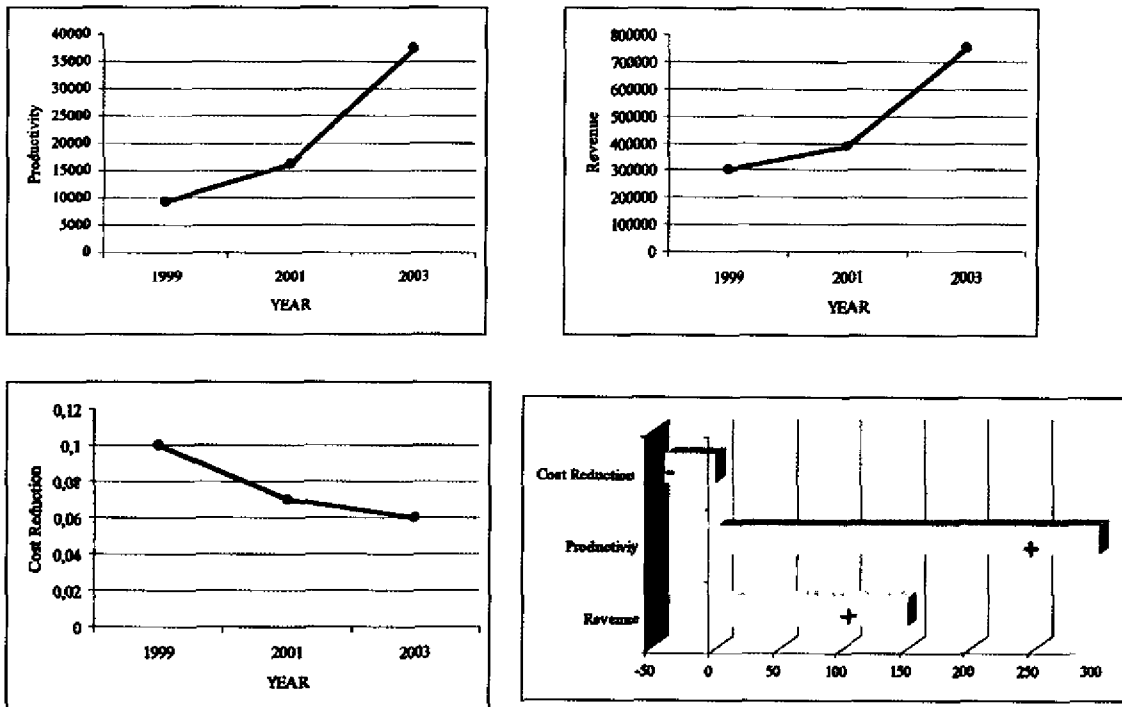
- Business performance,
- quality performance,
- environmental and social performance.

Business performance³⁷

Renata Engineering Plastics has been quantifying its results since 1999. The business performance has been impressive, increasing revenue by 150%, productivity by 300% and reducing production costs by 40% in only four years.

³⁷Part of the information obtained from the INSEAD and UNIDO questionnaire for business processes and supplier and customer integration.

Figure 1 | Business performance of Renata Engineering Plastics from 1999 until 2003



Cost reduction and revenue are measured in US dollars and productivity is measured by dividing annual sales revenue by total number of employees.

Quality performance

Renata has also improved its quality of performance, reducing customer complaints by 75%, the product defect rate by 68% and capacity loss by 35%.

In addition to these indicators, the other quality performance indicators that have been quantified are:

- *On time delivery*: measured by the percentage of how many products were delivered on time. Since 1999, there has been an improvement of 20%.
- *Rate of rejects*: measured by the percentage of rejected products. There has been an improvement of 40% in the last four years and only six per cent of production is currently rejected.
- *Changeover time*: measured by the minutes spent on average on one machine. Renata has reduced the changeover time by 50% since 1999 and currently spends 60 minutes on changeover.

*Renata
recycles
100% of
the water.*

Improvements of environmental and social indicators in companies are best achieved if the management seeks to integrate tools to improve social and environmental impact with tools to improve quality management.

Environmental and social performance

Environmental and social aspects are harder to quantify. Although Renata Engineering Plastics is not comprehensively quantifying the impact it has on the environment and the community, Mr. Thawani showed concern and indicated that measuring the socio-environmental impact of the company was a mid-term goal for which he required technical support.

Nevertheless, by upgrading its technology Renata has achieved several positive results related to the environment since 1999 and has developed a much more integrated policy towards its employees.

As a result Renata has achieved improvements in its environmental performance mainly through the application of adequate management methodologies, which are integrated into its overall management approach within its business plan.

This fact proves that the improvements of environmental and social indicators in companies are best achieved if the management seeks to integrate tools to improve social and environmental impact with tools to improve quality management. This is beginning to happen at the cutting edge of CSR development in the North with the move from separate consideration of social, environmental and economic issues towards sustainability management and the increasing importance given to the business case.

However, social and environmental pressure on suppliers tends to be piecemeal and unrelated to the business case. CSR initiatives, embedded in a business linkages concept, should include support in quality management for SMEs and focus on the business case as well as on compliance mechanisms. Equally, initiatives that focus on general business development, upgrading and training support for SMEs should integrate social and environmental management skills both in relation to entering into global value chains and serving local markets.

As it can be appreciated by the results described in Figure 1, Renata Engineering Plastics has achieved a very successful improvement in reducing its energy consumption per ton produced since 1999, a total reduction of 60%.

Furthermore, Renata recycles 100% of the water it uses through its system thanks to the investments in environmentally sound technology to filter and re-use all the water that is consumed through the production process. Water that is not used by the system is re-utilised in a new garden the company has created to improve the working environment for

employees. In addition, the company also plans to invest in a compost plant to recycle solid and garden waste.

In terms of social performance, Renata has just started quantifying indicators that measure employee satisfaction. One of the new requirements of the company is to invest 125 hours a year per employee for external training. Another positive aspect is that Renata's commitment to employee safety has led to zero accidents during 2002.

Global Compact performance model

As a result of the Global Compact Policy Dialogue 2002 on Business and Sustainable Development, a performance model was proposed to enable companies to replicate and scale up the good practices that integrate the Global Compact principles into company performance.³⁸ The model is built on the principle of continuous improvement to achieve world class in a context of continuously more demanding, competitive benchmarks.

A brief assessment of Renata's integration of the nine principles based on the Performance Model's 10 elements follows:

Vision

Renata's vision is to achieve world class in its core business of plastic moulded components. Mr. Thawani and the core management team are very aware that in order to achieve this, it is necessary to implement quality management systems, integrate the employees in the decision making process and adopt a proactive approach towards integrating their environmental impacts.

Enablers

As defined by the Global Compact Performance Model, enablers are necessary elements to ensure excellence in every objective the business chooses to pursue. The elements proposed by the model in this category are leadership, empowerment, policies and strategies, allocation of resources and process innovation.

Social and environmental indicators:

- Energy reduction per unit produced: 60%,
- water recycled over annual consumption: 100%,
- component materials recycled per year: 20%,
- annual hours of training to employees: 125 hours per year,
- accidents occurred: 0.

³⁸Global Compact Learning Forum – Briefing paper, UN Global Compact, April 23, 2002.

Mr. Thawani is convinced that in order to achieve a world-class level in Renata's core business, it will be necessary to adopt environmentally responsible practices, create a respectful employment situation and promote social development to have a positive impact on the community and along the production chain.

In order to do that, he has empowered his management team by engaging them in the formulation of the operations strategy of the company and the implementation of changes.

His strategies focused on the improvement of quality and moving up the value chain. The company integrates research and development and process innovation in tool designing and product improvements.

In a recent questionnaire given to the employees of Renata, a big majority strongly agreed with the following statements:

- People often do favours for one another and will go out of their way to help each other.
- People are encouraged to bypass formal channels to get their jobs done.
- Questioning and debate is openly encouraged in the organisation.
- There is a well-known and effective process for reviewing new ideas and suggestions put by the workers
- Budgets and other resources are very fluid in the company and can be easily re-deployed to new projects without much bureaucracy.

Results and reporting

These aspects (results and reporting) of the Performance Model reflect to more than the financial and direct operational output parameters. The concept of results is more holistic and stimulates a broader vision of the role of the business in its social environment. Its elements imply the impact the company has on people, on society and on the value chain. In addition it also suggests reporting on performance and measuring the improvements of processes, as well as social and environmental excellence.

As seen, Renata is not only quantifying its business performance, but it's also quantifying quality performance and evaluating its environmental and social impact. The company is starting to measure aspects like its defect rates, absenteeism, employee training and energy and water consumption, among others. To this point, Renata has not published any annual report with its quality, social and environmental performance, but they are currently considering it and might publish one in the near future.

Enhanced business linkages

Renata Engineering Plastics has achieved substantial results in terms of business linkages. At the beginning of the programme, Renata supplied a few customers with a limited range of goods. As a result of the partnership with UNIDO and other organisations, the company was able to expand its product base from delivering low-quality plastic components to two companies without any significant added value, to delivering more than 60 different types of high-quality plastic components that are now supplied to more customers in a variety of industries, including automotive, consumer durables, electronics, telecommunications and engineering.

Finally, as a result of its successful participation in the programme, Mr. Thawani, CEO of Renata, has been invited to participate in a seminar on productivity and efficiency that will be held in Japan in December 2003. Therefore, the programme has helped Renata not only to develop business linkages with the local industry, but also to increase the potential for international linkages through exposure to players and techniques in the global market.

Lessons learned and questions unanswered

As a participant of the partnership programme, Mr. Thawani has appreciated the importance of business linkages within the current context of highly competitive world markets. He learned that through discipline and organisation and by adopting an approach that continually improves and upgrades the production system, Renata Engineering Plastics can excel as a truly world-class competitor, even as an SME.

According to him, partnerships are essential “because as SMEs we just can’t generate the economies of scale required to bridge the technological and knowledge gap. Working together among different actors, sharing information and know-how and being able to know where we are positioned versus the rest of the world, is essential for survival.”

With such a mindset, Mr. Thawani has also been capable of overseeing the challenges that Renata faces in order to improve business linkages at global levels. According to him, the major question for Renata now is

Partnerships are essential “because as SMEs we just can’t generate the economies of scale required to bridge the technological and knowledge gap. Working together among different actors, sharing information and know-how and being able to know where we are positioned versus the rest of the world, is essential for survival.”

Mr. Rohit Thawani
Renata Engineering Plastics
CEO

how to move up the value chain and shift from a producer of plastics components to a producer of finished products.

In this sense, the programme has given him the tools and means to achieve internal discipline, to acquire quality management and cost effectiveness techniques, and especially, to establish a corporate standard toward progress, self-established targets and demanding goals on production and management.

According to Mr. Thawani, however, one of the remaining unanswered questions is how to benchmark oneself with the rest of the market. Based on his experience in the programme, he has assigned targets for annual employee training sessions, for efficient delivery, for rejection of products and defects and for achieving perfection in general. What he admits to be lacking is an understanding of what these goals should be so that Renata Engineering Plastics can compete in the global market. He currently seeks further advice on how to define internationally relevant and achievable goals for his programmes.

CASE STUDY: METALMAN AUTO PVT. LTDS.

Description of the company

Background

Metalman was started in 1976 to manufacture electroplating and metal finishing work for the bicycle and auto industries. Since then the group has expanded and diversified. It now manufactures intricate deep draw sheet metal components; a range of tubular and sheet metal fabricated components; and provides advanced metal finishing techniques for tri-nickel chrome plating. It also has a well-equipped tool room for the manufacture and maintenance of dies, press, tools, jigs and fixtures.

Currently, Metalman is the supplier to M/s. Kinetic Motor Company Ltd. & M/s Bajaj Auto Ltd., as well as to other two- and four-wheelers in the auto industry. Between 2002-2003 it grossed nearly nine million US dollars. It employs 393 people.

The company owns three factories, two in Pithampur and one in Aurangabad that opened in 1997. The basis for this case study will be limited to an analysis of the factory in Aurangabad, Metalman Auto Pvt Ltd.

Participating in the business linkages programme

The factory began operation in 1998 with 20 employees. After four years it employed 190 workers, produced more than 370,000 units of product and grossed revenue of five million US dollars per year. Metalman's only customer is Bajaj Auto Ltd. As one of the key car manufacturers in India, Bajaj is undergoing supplier consolidation. In the past seven years alone it has gone from more than one thousand suppliers to 190.

Mr. Thorat, the Director of Metalman, understood that to maintain his business he would need to guarantee top quality products cost-efficiently. In 1999 Metalman became certified by ISO 9001 and initiated a process of improvement and technological upgrading. However, due to high market expectations and the growth of customer demand, Mr. Thorat was looking for in-depth change that would enable Metalman to readily adapt and have a competitive edge with Bajaj. At the end of 2002 Mr. Thorat received a letter from UNIDO and ACMA inviting Metalman to participate in the Business Linkage programme for the automotive sector.

*Metalman
became
certified by
ISO 9001
and initiated
a process of
improvement
and
technological
upgrading.*

"It came at the right time," says Mr. Thorat, "because we were expanding very quickly and needed to make sure our absorbing capacity would not jeopardise the quality or delivery requirements of our customers."

The programme began February 2003 and will last 30 months. It includes 40 companies from four different regions of India and offers different types of activities as models for continuing improvement. The programme includes:

- Classroom training sessions for a selected group of SMEs on quality management, cost efficiency and delivery of products.
- Two visits a month by an international expert to evaluate corporate performance, propose best practices for improvement, change management practices and assign tasks to the management team.
- A monthly meeting among the regional cluster to jointly evaluate performance. The meeting is held at one of the SME sites, with each member evaluating the performance and improvements of the company visited. In addition, each company must provide a 10-minute presentation highlighting achievements and pointing out areas for improvement.

Outcome and proven results

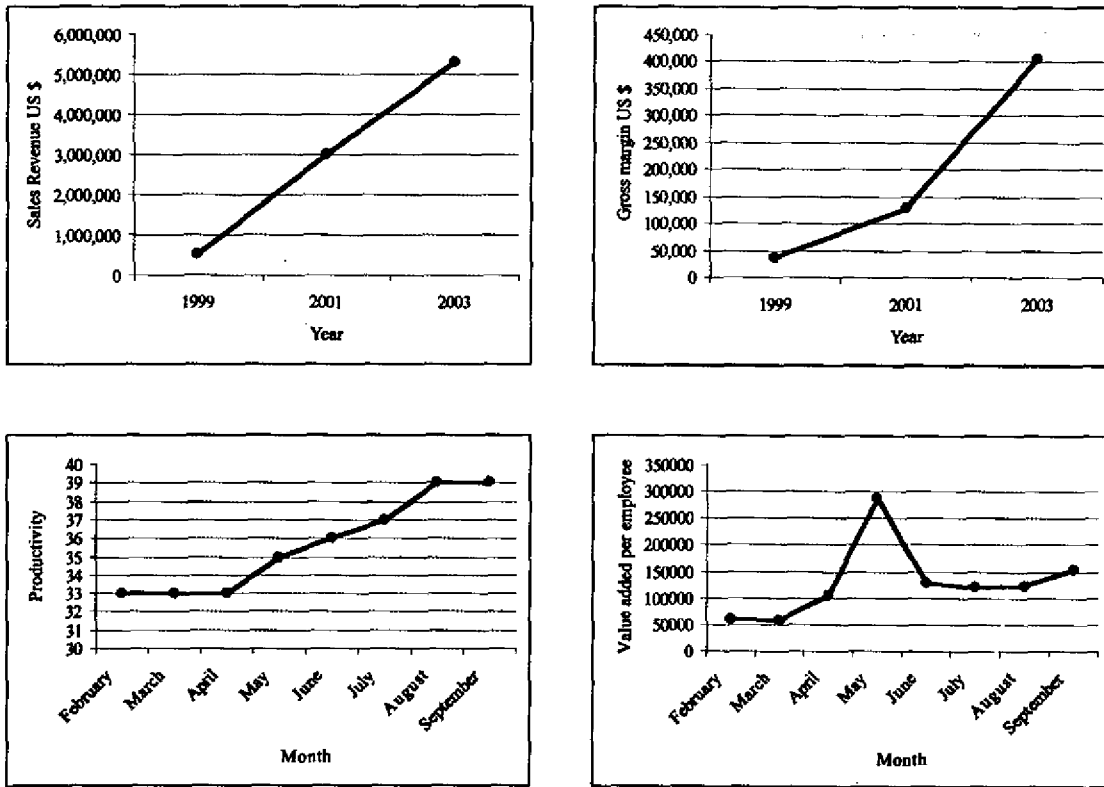
Metalman's performance has been evaluated according to the three criteria defined in the Renata case study (business performance, quality performance and environmental and social performance). However, since Metalman began its participation in the programme only recently, most of the quantitative analysis has been done only since that date.³⁹

Business performance

Metalman has increased its productivity by 18% since February 2003 while the added value per employee has increased 150% (data is not available before that).

³⁹Part of the information obtained from the INSEAD and UNIDO questionnaire for business processes and supplier and customer integration.

Figure 2 | Business performance of METALMAN AUTO PVT. LTDs since 1999



Quality performance

Since the partnership with Metalman was initiated only in February 2003, not much data is available to indicate the results in terms of quality performance. However, some indicators have already shown an improvement of the company's productive process since it started with the Business Linkages programme. The following quality improvements have been quantified:

Number of defects: indicates the number of defects due to mishandling, wrong operation, stacking, etc. Since February 2003, this number has been reduced dramatically by 91% and achieved minimum levels in the most recent months.

Tool change time: measures the minutes spent on tool change on average. Since February 2003, Metalman has been able to reduce tool change time by 28%, which is currently equivalent to 16 minutes. To achieve this gain the company started an action plan that ensures, for instance, that all required tools and gauges are accessible near the machines.

In addition, Metalman has drastically reduced customer complaints to only one per month, a drop of 85% from February.

Environmental and social performance

Although social and environmental aspects are hard to quantify, as in the case of Renata, Mr. Thorat has developed awareness of the relevance of these issues as well as of the need to assess the company's achievements in such areas. As a positive result, despite the initial stage of the partnership programme, Metalman has already obtained some considerable improvements.

In terms of environmental performance, by implementing best practices Metalman has achieved substantial savings in the consumption of energy and resources: 90 man-days per month in manpower, 24,000 litres per month in water and 260 units per month in electricity.

Although Metalman results in the area of social performance have still to be assessed and quantified, there have already been some positive indicators related to conditions of work and absenteeism.

Number of accidents per employee per hour/ and number of days lost per employee a year: following the implementation of the partnership programme in February 2003, accidents were rapidly reduced to practically zero. Although the introduction of new techniques caused a sudden increase in the number of accidents in July and August, the company quickly implemented training procedures that helped to bring the ratio back to zero in September.

In addition to these indicators, absenteeism among employees has also been reduced by 51% since the implementation of the programme.

Global Compact performance model

Metalman has demonstrated its awareness of the importance of the Global Compact objectives. In the following an assessment of Metalman's integration of the Global Compact nine principles through the 10 elements of the performance model is described:⁴⁰

⁴⁰The Global Compact Performance Model – Output paper of UN Global Compact Policy Dialogue, July 2002.

Vision

Metalman's vision is to be competitive on a global scale and to be able to supply not only Indian manufacturers but also to global producers. They aim to achieve this by excelling in quality, on time delivery of products and guarantee of cost-effective goods. As Mr. Thorat, the Director of Metalman, has reported, they want to eliminate defects, breakdowns and accidents and achieve cost reduction and on time delivery of products through the introduction of best practices and total productive maintenance (TPM).

Enablers

Mr. Thorat has shown full awareness of the importance and the need for companies to adopt environmentally responsible practices and promote social development through adequate employment practices.

While the continuation of the partnership programme is expected to bring further concrete actions by Metalman in these areas, the company and its management have been truly motivated to implement policies and strategies that aim at achieving higher levels of performance at various levels. Some examples we have seen included the introduction of innovative best practice processes that resulted in substantial gains in quality and upgrading of the productive process.

Results and reporting

Metalman is making a strong effort to quantify its business performance, but also its quality achievements as well as its environmental and social impacts. As we have seen, the company has started to measure and pay attention to indicators such as defect rates, employee absenteeism, energy and water consumption and others.

Although the company has not been required to publish annual reports so far, they are willing to provide them whenever necessary.

Enhanced business linkages

Having joined UNIDO's programme, Mr. Thorat has understood the crucial role business linkages play in the current scenario faced by Metalman. The company's only customer, Bajaj, has gone through a process of consolidation of its supply base, which has been reduced from more than 1,000 to approximately 190 companies. Therefore, staying in business

“In order to create business linkages with the global market,” says Mr. Thorat, “we need to compare ourselves with European and Japanese companies; we need to know what kind of goals they are setting, so we understand better what is required to compete in the global market.”

becomes Metalman’s predominant objective. As this became more and more difficult, a continuous improvement process needed to be installed within the company to meet the constantly increased demand from the customer. The business linkages programme provides the framework and the tools and technologies and has supported Metalman in its efforts to keep up with its client’s requirements.

Metalman received the last two best supplier awards given by Bajaj, thus showing its successful achievements in creating business linkages. In addition, the participation in the programme has allowed the exposure of the management of Metalman to the practices and demands of other players in the industry, including foreign companies. Such awareness is important to increase the potential for creating further business linkages with new clients and global markets.

Lessons learned and questions unanswered

Although the programme began only in February 2003, Metalman has achieved tremendous results and significantly improved its performance. The company has participated actively in the programme and has created the type of ownership that will allow achieving a highly competitive performance.

One of the crucial lessons learned according to Mr. Thorat is the opportunity to visit other component supplier companies of the programme once a month and be able to see how they are dealing with their problems.

“We are all facing similar problems in our industry,” says Mr. Thorat, “being able to participate in the programme and understanding how other companies are managing their business allows us to position ourselves better and adopt a continuous improvement approach.”

Mr. Thorat acknowledges that the programme is giving him the necessary tools to improve quality, excel better in on-time delivery and become more cost-effective. This allows Metalman to create more competitive business linkages and to access global markets.

One of the remaining unanswered questions for Metalman is how to benchmark itself with the whole global market. The programme has allowed Metalman to benchmark with other component companies from India, but Mr. Thorat feels there is a lack of understanding on how other companies are globally managing themselves and what kind of targets they are setting to improve performance.

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