

## **ANNUAL MEETING 2004**

GOVERNORS OF THE WORLD ECONOMIC FORUM  
FOR FOOD, BEVERAGE, RETAIL AND CONSUMER GOODS

DAVOS—THURSDAY 22 JANUARY

## **RESPONSIBLE VALUE CHAIN: WHAT ARE YOU ACCOUNTABLE FOR?**

**Value chain accountability**

by James Allen, Bain & Company

# Value chain accountability

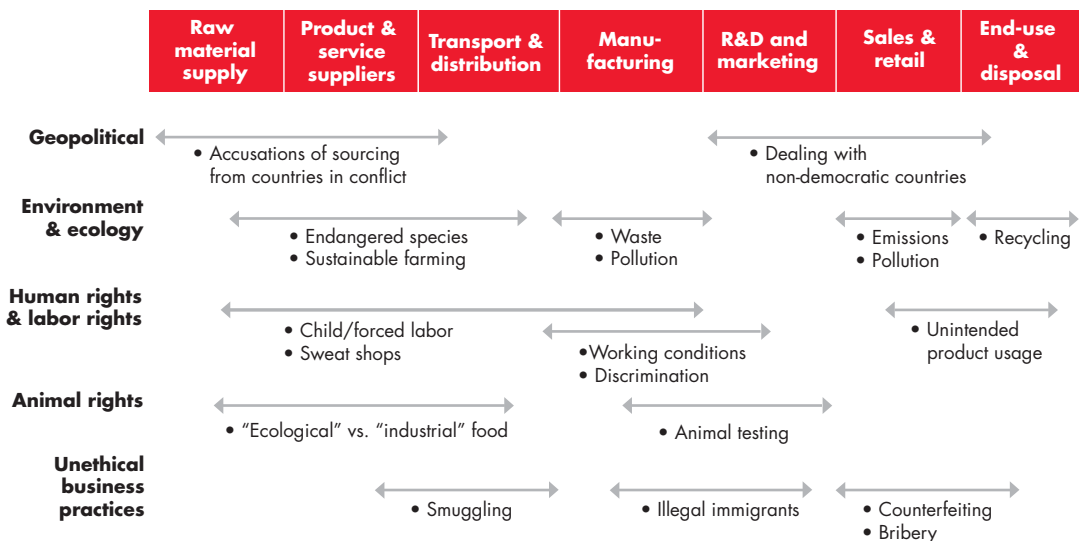
How accountable should branded-goods companies be for activities in their value chains, even those that they do not directly control? As more NGOs target big branded companies with “brand mail” to raise awareness of key social issues, and as activism rises amongst key consumer groups, boards and senior managers spend more of their time on issues of “value chain accountability” or “sustainable supply chains.” Examples abound: Nike is tagged for not doing more about children employed by its suppliers; Shell, BP and Exxon wrestle with claims of environmental damage; De Beers must address the issue of conflict diamonds; Nestlé and Kraft face pressure over exploitation of coffee growers. Many of these cases are not new, but the sophistication of NGOs and consumer groups appears to be growing: Increasingly, they target big brands as a way to define and resolve global social issues.

## What’s it all about?

Many of the issues first raised by NGOs and consumer groups had to do with corporate obligations toward the communities that supply important products or services and the need to make those communities sustainable. We prefer a broader definition of value chain accountability, which extends beyond supply sources to include networks of distributors and consumers. In an increasingly multinational environment, CEOs must constantly balance their efforts between consumer and supplier communities. The first step is understanding the full range of issues that define the concept of “value chain accountability.” (See figure 1)

Many of these issues date back to the beginning of brands. Over a century ago, for instance, Nestlé worked closely with Swiss dairy producers to ensure sustainable supplies of high-quality milk for its products. But three clear trends make this issue more complex and more urgent for a company aiming to be successful in the 21st century: Value chains are getting more complicated, social awareness is increasingly global, and consumer groups and NGOs are becoming more sophisticated and systematic.

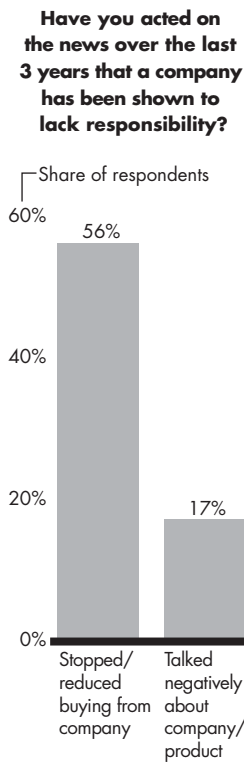
Figure 1: Value chain accountability—a wide range of issues



Note: Selected examples of issues and areas in value chain where issues would arise.

Value chain accountability

Figure 2:  
Consumers claim  
to take action



Source: Bain consumer research

To help frame this issue for debate at the World Economic Forum’s annual meeting in Davos, Bain & Company has interviewed hundreds of consumers and two dozen of companies and NGOs. Six key themes emerged from our findings.

**1. Focus on brands not boycotts**

Most consumer research on this topic, including our own, agrees on two points: Media reporting on “bad” corporate behaviour across the value chain definitely affects consumer attitudes toward the brand, and most consumers intend to punish perceived corporate offenders by choosing an alternative product. (See figure 2) Yet, NGOs and consumer groups tend to exaggerate the impact of boycotts on companies: Most consumers do not follow through on their desire to punish the offender.

At the same time, companies tend to underestimate the impact of negative attention on the brand itself. Apathy or animosity toward a brand can be harmful, even when it doesn’t lead to a boycott. Bain research clearly demonstrates a positive relationship between a company’s growth rate and the number of customers enthusiastic about recommending the company’s products or services to a friend. Companies can determine their “net promoter” score—the number of consumers willing to enthusiastically recommend the brand to a friend minus the number of consumers that would not recommend the brand.<sup>1</sup> Negative publicity on value chain accountability issues can decrease the number of net promoters for your products and thus slow your future growth rate. (See figure 3)

**2. Build values not departments**

The companies most effective at addressing the issue of value chain accountability had two things in common: The CEO personally took responsibility because he or she saw it as a matter of corporate values, and the CEO ensured that all employees felt empowered to identify and resolve problems in the value chain as they arose. Said one chief executive at a recent conference in London: “The worst place to address this issue is in the public affairs or corporate responsibility department.”

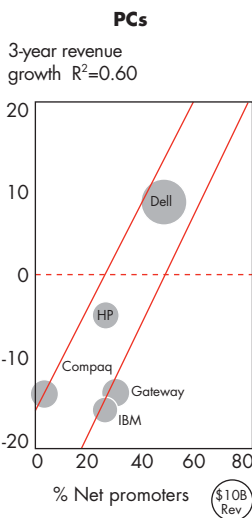
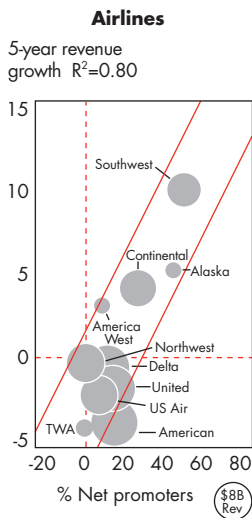
The most effective companies were proactive about using responsible suppliers, not because they were worried about media headlines but because that was the only way to do business. The media have praised De Beers for its initiatives to reduce the trade of conflict diamonds. Gary Ralfe, Managing Director of De Beers, credits Global Witness for bringing the issue to his attention. But the real momentum developed after De Beers employees began to argue that the conflict diamonds issue fundamentally undermined what De Beers and the industry should stand for—the romance and mystique of diamonds.

**3. Define borders and battleplans**

A company must choose where to focus its efforts. As one CEO put it: “Taking accountability for your value chain is a big job, and it’s folly to think any company can ensure that all activities across the value chain can reflect all our values, all the time.”

<sup>1</sup>Frederick F. Reichheld, “The One Number You Need To Grow,” *Harvard Business Review* (December 2003): 46-54.

Figure 3: Consumer net promoter score correlates to top line growth



Note: Revenue is 2001 US domestic revenue stated in USD

Source: Satmetrix; analyst reports; Bain Analysis

One food-products company effectively focused its efforts by choosing different approaches, or “engagement models,” depending on how close an issue was to its core business. (See figure 4) Tier one issues involved the part of the value chain most clearly associated with its brand or which represented a significant part of the cost structure for its leading products. These issues require direct engagement with NGOs or consumer groups—footwear suppliers to Nike, for instance, or coffee suppliers to Kraft.

Tier two issues arise when a company has active knowledge of an issue through its day-to-day activities, even though its direct involvement is limited. Conflict diamonds were such an issue for De Beers: The company was not trading in conflict diamonds, but its employees understood the potential harm to its ability to market polished diamonds.

Tier two issues are often best pursued by participation in broad initiatives on the topic and should not necessarily be pursued through unilateral action.

Tier three actions arise when the company has no involvement but the problem is so at odds with its own values that the firm must take a position. Here, it is best to state the company position and encourage relevant parties to resolve the issue but not focus significant company resources to help.

Tier four actions encompass all the rest. Although their methods differ, the most effective companies clearly define issues into some form of tiering and have a plan for engagement with each tier.

#### 4. Let NGOs be NGOs

Clearly, companies can only go so far to resolve value chain accountability issues. Companies face two challenges as they try to align their interests with NGOs:

Figure 4: Issue prioritization depends on level of risk and degree of influence

	Type of issue		
	Tier 1 issue	Tier 2 issue	Tier 3 issue
<b>Tests:</b>	<ul style="list-style-type: none"> <li>Brand clearly associated with part of value chain where issue arises</li> <li>Issue impacts a large share of product cost base</li> <li>Company has strong ability to directly influence issue</li> </ul>	<ul style="list-style-type: none"> <li>Not Tier 1 but company can directly influence issue</li> <li>Significant employee awareness/ involvement of issue requiring company to respond consistently with values</li> </ul>	<ul style="list-style-type: none"> <li>No direct or indirect company involvement in issue</li> <li>Company values result in need to take position</li> </ul>
<b>External pressure for company action</b>	<ul style="list-style-type: none"> <li>Very high</li> </ul>	<ul style="list-style-type: none"> <li>High</li> </ul>	<ul style="list-style-type: none"> <li>Medium</li> </ul>
<b>Preferred approach</b>	<ul style="list-style-type: none"> <li>Unilateral, potentially in cooperation with NGO</li> </ul>	<ul style="list-style-type: none"> <li>Industry-wide</li> </ul>	<ul style="list-style-type: none"> <li>Cross-industries</li> </ul>
<b>Examples</b>	<ul style="list-style-type: none"> <li>Body Shop (ecology/ethics)</li> <li>Starbucks (sustainable agriculture)</li> </ul>	<ul style="list-style-type: none"> <li>Kimberly Process (diamonds)</li> <li>Portman Group (alcohol)</li> <li>Fair Label Association (apparel &amp; footwear)</li> </ul>	<ul style="list-style-type: none"> <li>HIV/AIDS</li> <li>Education</li> </ul>

**Sharing responsibility for change**

The push for greater accountability and transparency is not confined to the corporate and public sectors. As the numbers and influence of organized citizen’s groups grow, so do calls for mechanisms that shed light on their internal practices. Some NGO’s find the largest brands make the most effective targets for social change, even on issues that have little to do with the firm’s value chain. Similarly, the most responsive corporations are targeted more frequently—precisely because of their responsiveness. Can NGOs commit to standards without sacrificing their roles in civil regulation and social innovation? What can organizations of civil society learn from the corporate sector’s efforts to self-regulate?

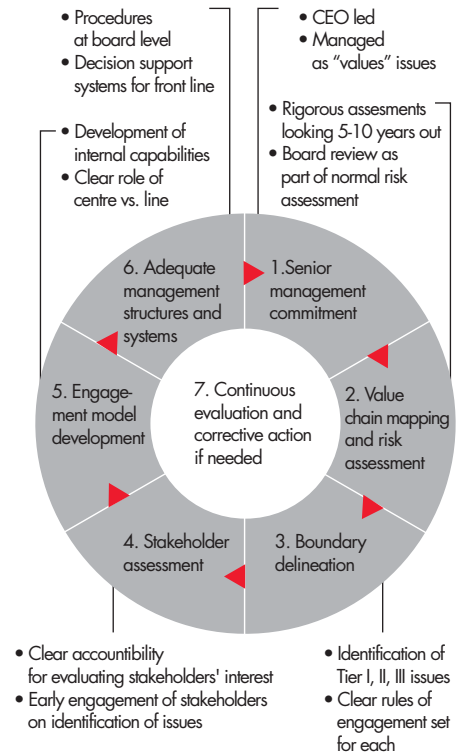
- Brand mail is great for publicity:** NGOs pursue two different sets of activities—issue identification and issue resolution. When they are identifying issues, NGOs are working to publicize the issue, to attract media and consumer attention and funding. One way to do this is to confront the brand owners. But during these confrontations, they have no incentive to take the issue off-line. They want to use a big brand to maximise publicity for the cause. As a Greenpeace activist once put it: “[Focusing on brands] was like discovering gunpowder for environmentalists.”
- NGO success requires outsider status:** Many NGOs work hard to position themselves as objective outsiders, free and able to call companies to account for wrongdoing. Too much publicity about working closely (and quietly) with a company to resolve an issue can suggest that the corporation has co-opted the NGO. Indeed, NGOs can lose funding overnight if supporters perceive them as too cosy with corporations.

Effective companies know what they can and can’t do on an issue and work hard to avoid devoting resources to areas where alignment of interests is impossible.

**5. Implementation: It’s not about what, it’s about who**

Even when companies identify what they must do to address value chain issues, they often struggle to identify who should do it. Best practices must be initiated both at the very top and at the bottom of the organization. Boards need to consider risks to the business, but core knowledge and most activities really take place at the front line. Our research indicates that companies that deal well with issues of value chain accountability follow a logical set of actions outlined in Figure 5.

Figure 5: Value chain accountability best practices



**6. Goodbye to the arts? CSR redefined**

A number of CEOs raised a related issue: Value chain accountability may turn out to limit the scope of corporate social responsibility. Companies may wish to spend a lot of money and time on philanthropy, but in reality they cannot afford to ignore issues that affect the value chain. Once they’ve dealt with value chain issues thoroughly, will there be any resources, time and money left to donate to the arts and other areas? Should there be?

In conclusion, CEOs must make sure that everything their companies do in every community in which they operate reflects key corporate values. Rather than set up another department for social responsibility across the value chain, the CEO should focus on ensuring that the company’s brand and its values are understood and lived by all employees, especially those on the front lines.

## **Bain's business is helping make companies more valuable.**

Founded in 1973 on the principle that consultants must measure their success in terms of their clients' financial results, Bain works with top management teams to beat their competitors and generate substantial, lasting financial impact. Our clients have historically outperformed the stock market by 3:1.

## **Who we work with**

Our clients are typically bold, ambitious business leaders. They have the talent, the will, and the open-mindedness required to succeed. They are not satisfied with the status quo.

## **What we do**

We help companies find where to make their money, make more of it faster and sustain its growth longer. We help management make the big decisions: on strategy, operations, technology, mergers and acquisitions, and organization. Where appropriate, we work with them to make it happen.

## **How we do it**

We realize that helping an organization change requires more than just a recommendation. So we try to put ourselves in our clients' shoes and focus on practical actions.

## **For further information, please visit [www.bain.com](http://www.bain.com) or contact:**

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