Corporations are being called to account for the impact their suppliers have on local communities and the environment. Bain & Company's James Allen, Jean-Pierre Felenbok and Martha Stack, MBA '01D explain how companies can effectively manage this new "brand tax".

Value-chain accountability: Making the numbers add up

Boardrooms have replaced barricades as the new front line in the debate over globalisation. Companies, governments and non-governmental organisations (NGOs) are engaged in ongoing discussions nowadays about the risks and opportunities of global business expansion. It seems a long way from the clashes marked by protestors shouting in the streets. Yet the new civility hasn't yet cracked some vital questions: How will these groups now work together to increase security and prosperity as globalisation plays out? And who will pay for the added costs of greater accountability?

Today's defining issue comes down to this: To what extent are businesses responsible for bad things that happen along their value chains – even among remote suppliers over which they have no control? Clearly, some mix of free-market and regulatory measures are needed to address this matter of "value-chain accountability". Yet where are the boundaries of responsible behaviour? Who enforces what rules, over what geographies? And how do responsible firms avoid putting themselves at a competitive disadvantage? Opinions differ.

At one end of the spectrum, proponents of a free-market approach argue that businesses already have sufficient incentives to improve corporate behaviour. Indeed, they believe that firms must "own the problem" to contain the social and environmental damage done by heedless participants in value chains.

Regulatory advocates argue that most companies will focus first on reducing costs, rather than enhancing their brands or protecting their reputations from the uncertain consequences of consumer backlash. This group argues for minimum standards around labour rights, environmental controls and protection against destructive trading practices enforced through binding multilateral agreements that put all firms on the same footing.

Both of these approaches, regulatory and free-market, will fail to improve accountability without a more detailed understanding of the real costs to companies from consumer backlash – as well as the real opportunities to add revenue or build more profitable growth by strengthening accountable value chains.

The current debate echoes the wrangling over automobile safety that took place in the US during the 1960s and 1970s. Automakers eventually came to recognise society's mandate by adapting their products and systems. Indeed, Volvo introduced the three-point safety belt way back in 1959. But the absence of any clear value to shareholders from investing in safety delayed industry-wide solutions. Only when a critical mass of customers began buying cars based on their safety features did automakers respond with more than the regulatory minimum.

Clearly, some combination of free-market and regulatory approaches will once again be necessary to get the balance right on value-chain accountability. But the outlook for free-market approaches is mixed.

Seeing the benefits

The good news is that companies "get it". Businesses have long understood the fallout that can result from being associated with practices branded as exploitative. What's changed is that leaders of companies with household names now understand the importance of protecting their brand reputations by doing good – and, more important, being perceived by customers as doing good – when it comes to issues of value-chain accountability. Some major companies have made great headway on addressing accountability.

Consider, for example, the Common Code for the Coffee Community, a joint effort by NGOs, coffee-producing nations and some of the world's largest coffee marketers to lay the groundwork for improved working conditions and environmentally friendly practices in producer countries. Other industries, including forestry products and fisheries, have launched similar initiatives.

Indeed, many executives now recognise the benefits of greater accountability: It protects their firms' reputations and helps insulate brands against detractors. It can bolster employee retention, making a responsible company a preferred place to work. It demonstrates that sustainability is part of a company's model, which can help attract and keep investors.

To fully explore this issue, Bain & Company interviewed hundreds of consumers and two dozen companies and NGOs. We expanded our research with more than three dozen CEO discussions. Out of those interviews four key themes emerged:

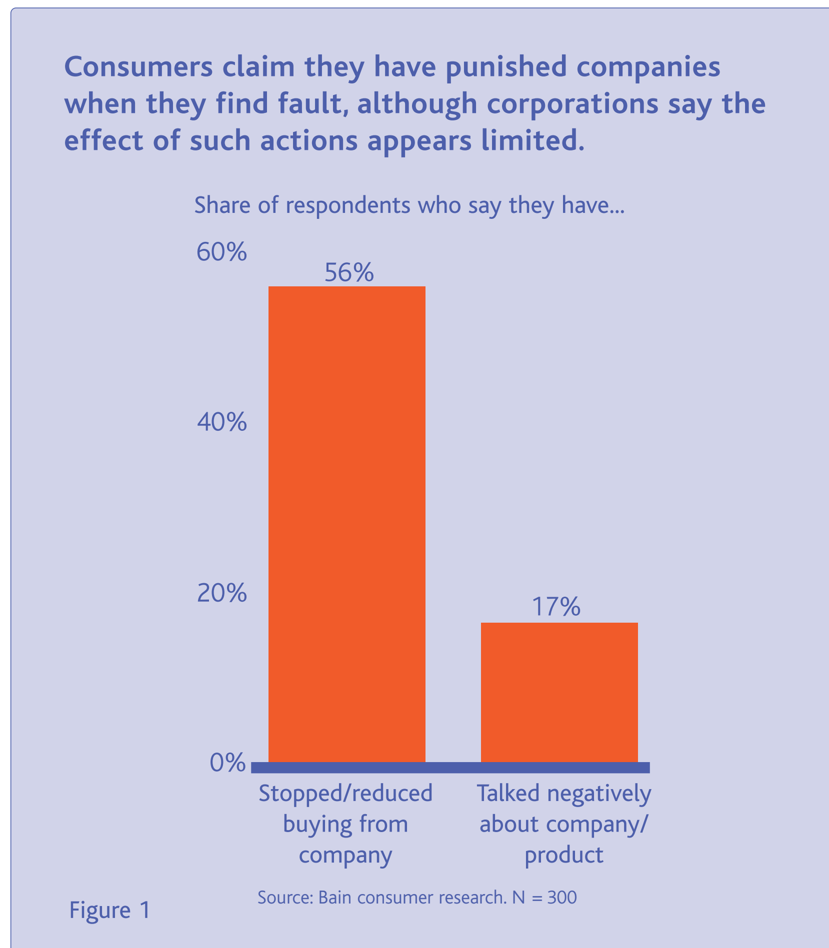

Figure 1

1. Focus on brands, not boycotts

Most consumer research on this topic, including our own, agrees that media reporting on "bad" corporate behaviour across the value chain does affect consumer attitudes. Many consumers say they intend to punish perceived corporate offenders by choosing an alternative product (see Figure 1).

Yet, it's not the threat of a consumer boycott that spurs companies to focus on accountable value chains. Our research confirmed that these threats are often exaggerated, in any case. Rather, CEOs recognize that their companies' brands are at stake, and being associated with dubious activities of suppliers, however distant, can tarnish relationships with consumers, employees and investors. 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. Companies can determine their "net promoter" score with this simple equation: the number of consumers willing to enthusiastically recommend the brand to a friend minus the number of consumers who would not recommend the brand (see Figure 2, page 22). Negative publicity on value-chain accountability can decrease the number of net promoters and thus slow growth rates. This commitment by CEOs to protect the brand at all costs – not the impulse to engage in damage control – is at the heart of value-chain accountability.

2. Build values, not departments

Companies that are most effective in addressing value-chain accountability have two things in common: The CEO personally takes responsibility as a matter of corporate values, and senior management ensures that all employees feel empowered to resolve problems in the value chain as they arise. Said one chief executive: "The worst place to address this issue is in the public affairs or corporate responsibility department."

Effective companies are proactive about using responsible suppliers, not because they worry about headlines, but because that is the best way to do business. For example, the media have praised De Beers for its initiatives to reduce the trade of conflict diamonds, precious stones sold to finance civil wars and repression in the countries where they are mined. 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

Enthusiastic customer referrals correlate strongly with top-line growth in some industries, especially in service-intensive businesses

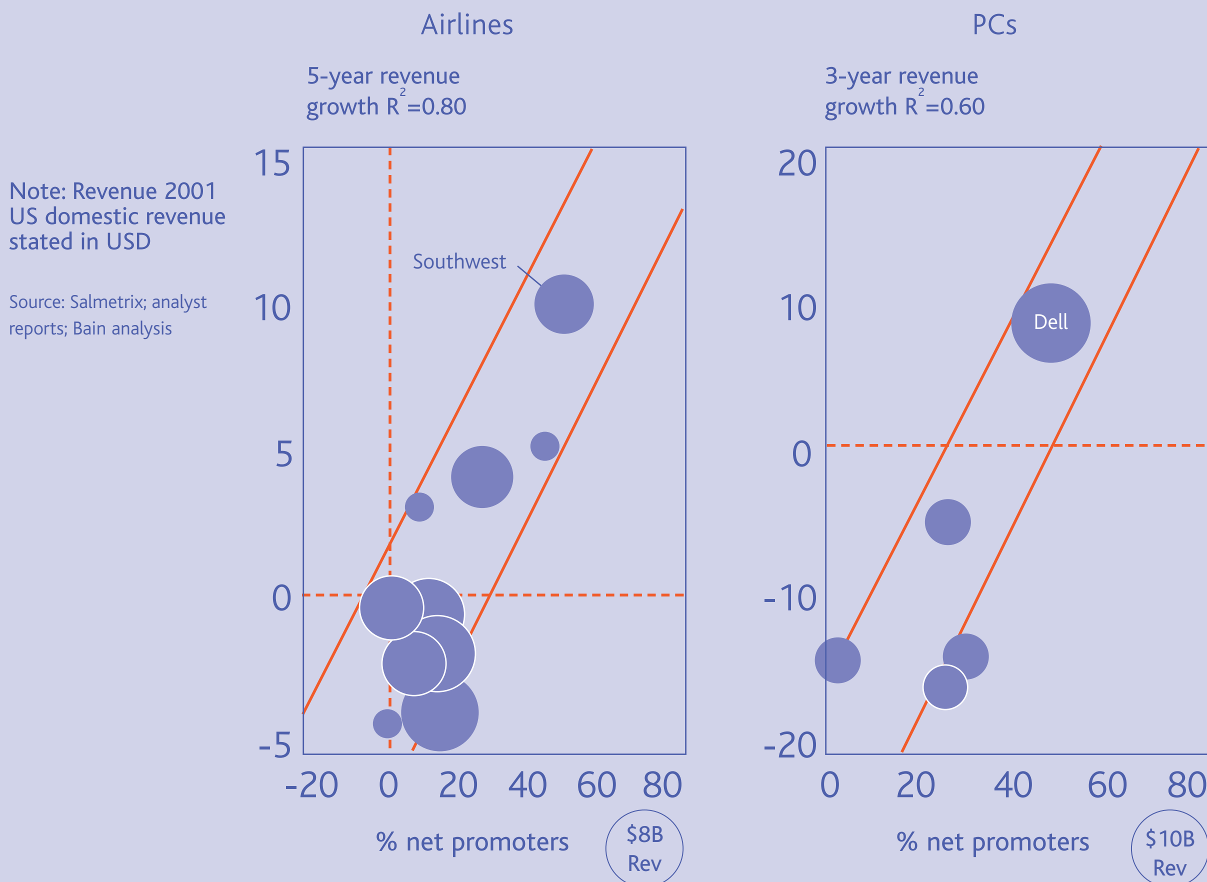

Figure 2

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. The moral compass of employees guided the firm's actions.

3. Define borders and battle plans

Effective companies also choose where to focus their efforts, depending on how close they are to their core business. 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."

One food-products company uses different "engagement models" to prioritise its responses. Issues involving that part of the value chain most clearly associated with its brand get the most attention. For a sportswear company like Nike, that would mean focusing on the activities of its shoe suppliers, or for Kraft, the activities of coffee growers. These issues require direct engagement with NGOs or consumer groups.

Less engagement is necessary when a company is aware of an issue but its direct involvement is limited. For example, De Beers was not trading in conflict diamonds, but its employees recognised that the negative imagery threatened to undercut De Beers' marketing strategy, and pressed for action. These kinds of issues are often best addressed through participation in broad initiatives on the problem.

Sometimes a company has no direct involvement with an issue, but the problem is so at odds with a company's values that it must take a position. Here, it is best to state the company position and encourage relevant parties to resolve the issue, but not to focus significant company resources to help.

Many companies have not yet created systematic approaches to addressing value-chain issues. In particular, companies could do better pursuing collective industry-wide responses on issues where the companies were not directly involved with that part of the value chain. Collective action in these areas is likely to provide a lower-cost solution and is also quite likely to lead to a better answer.

Our research indicates that companies that deal well with issues of value-chain accountability follow a logical set of actions, outlined in Figure 3 (page 24).

4. Let NGOs be NGOs

Companies also need to acknowledge that they can go only so far to resolve value-chain issues by aligning with NGOs that have different agendas. NGOs seek to attract media and consumer attention, as well as funding. One way to do this is by "brand-mail" – confronting the big-name brand owners. As a Greenpeace activist once put it: "[Focusing on brands] was like discovering gunpowder for environmentalists." During these confrontations, they have little incentive to take the issue offline. Moreover, NGOs fret about their own images. Publicity about working closely (and quietly) with a company to resolve an issue can suggest that the corporation has co-opted the NGO. 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.

Counting the costs

These best practices suggest ways for companies to manage value-chain risk. But the bad news, reported by CEOs we spoke to, is that assuming greater accountability adds significant costs with no corresponding premium for the business, at least not today.

Indeed, companies pursuing value-chain accountability must come to grips with a number of strong business trends:

1. Disintermediation/outsourcing

Over the last decade, firms have increasingly focused on a few core activities and outsourced the non-value-added activities. Consumer goods companies, for example, have narrowed their efforts to sales and marketing activities and a few areas of manufacturing and distribution to ensure product and service quality. This has resulted in less involvement with key areas of the value chain, and less potential influence to rectify bad situations.

2. Costs

Taking greater accountability for the value chain, by definition, adds costs. This is especially true where companies source from multiple suppliers in multiple locations and commodities traditionally are purchased on the spot market (e.g., coffee). In addition, there are costs borne by the third-party standard setters and certifiers to vet ethical norms and behaviours.

3. Systems and measures

Many senior executives admitted that their information systems and internal measures and rewards have not caught up with the notion of value-chain accountability. One CEO noted: "We still focus most of our sourcing measures around costs, rewarding our people who deliver the lowest-cost goods. We tell them to also worry about employment conditions in the factories where they source, but because we don't measure that as well, we are implicitly signalling that, at the end of the day, it's all about costs." Getting the right measures in place to balance costs with values is a key challenge.

4. Everyday low costs

As retailers consolidate more power in a few major markets (US/UK, for example), brand owners come under increased margin pressure to deliver on the promise of "everyday low costs". There's little left over to fund accountability.

5. No price premium

Finally, business leaders are unsure how they can benefit from taking greater accountability. Many say they learned the hard way that marketing yourself as a socially responsible company doesn't pay. Indeed, signalling that you are a "do good" company sets you up for more scrutiny and sharper attack. It is not even clear that being seen as taking greater accountability helps companies in their dealings with NGOs.

Even engaging in public debate about such issues can draw down intense criticism upon a company, which is one reason the discussion of value-chain accountability too often remains muted and unconstructive. Until chief executives can see their way clearly to sustained value creation arising from accountability, they are unlikely to invest what it takes.

Making the microeconomics work

What's the answer to this complex puzzle of doing well while doing good? Simply put, businesses, governments and NGOs must figure out a way to work together towards their common goal of increasing security and prosperity amid globalisation's destabilising forces.

For NGOs, a constructive first step would be to find ways to reward responsible corporations in a way that perpetuates desired behaviour. Some NGOs find that 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.

As corporations begin to embrace value-chain accountability, can NGOs commit to standards without sacrificing their roles in civil regulation? Can they use brand-mail judiciously and responsibly? Are new rules of engagement appropriate, or is the simple response "Let NGOs be NGOs"?

For companies and their CEOs, the way forward depends on collective action around a few important themes. Business needs a model for auditing value-chain accountability, which will allow companies to track progress on

Responding effectively to value-chain issues depends on level of risk and degree of influence

	Type of issue		
	Tier 1 issue	**Tier 2 issue**	**Tier 3 issue**
Tests:	• Brand clearly associated with part of value chain where issue arises • Issue affects a large share of product cost base • Company has strong ability to directly influence issue	• Not Tier 1 but company can directly influence issue • Significant employee awareness of/involvement in issue requiring company to respond consistently with values	• No direct or indirect company involvement in issue • Company values result in need to take position
External pressure for company action	• Very high	• High	• Medium
Preferred approach	• Unilateral, potentially in cooperation with NGO	• Industrywide	• Cross-industry
Examples	• Body Shop (ecology/ethics) • Starbucks (sustainable agriculture)	• Kimberley Process (diamonds) • Portman Group (alcohol) • Fair Label Association (apparel & footwear)	• HIV/AIDS • Education

Figure 3

the areas of greatest impact. Industry groups also can begin defining the rules for a level playing field, involving standards such as minimum labour rights, so that firms that invest in more accountable value chains won't put themselves at a competitive disadvantage. Progress in these areas will depend on a more rigorous assessment of internal costs and analysing whether accountable value chains can make significant contributions to sustainable growth.

Companies should also look for opportunities to pursue collective initiatives with the NGO community. Unilever did this in 1996 by working with the Worldwide Fund for Nature to form the Marine Stewardship Council, an independent certifier of sustainable fishing practices, which puts its stamp of approval on much of Unilever's whitefish supply.

In these areas, companies may begin to affect outcomes at a microeconomic level, and gain the permission of their shareholders to pursue greater accountability. Yet the largest issues will be resolved when government acts, as with the flurry of US auto-safety legislation in the 1970s.

Until then, neutral forums where business and government meet to discuss these issues have some clear opportunities. One is to create the right setting to debate NGO certification and an appropriate code of conduct. Another involves fostering debate on a "good citizenship" metric, which might help the most active companies receive consumer credit. Such forums can also play a natural role in defining the charter for collective industry action.

But the biggest obstacle still remains: Is there money to be made by doing the right thing on this issue? That question, which lies at the heart of the debate on value-chain accountability, must be addressed before the free-market approach can gain broad support among business leaders. To make the math work, eventually each constituency may need to give up a little so society can have more: consumers on choice and price, producers on practices, purveyors on margin and even NGOs on their purism. IQ

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