Harvard Business Review

The Big Idea: Creating Shared Value

Rethinking Capitalism

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January–February 2011 - http://hbr.org/2011/01/the-big-idea-creating-shared-value/ar/pr

What Is "Creating Shared Value"?

- ***Policies and operating practices that enhance the competitiveness of a company while simultaneously advancing the economic and social conditions in the communities in which it operates.***

The concept of shared value—which focuses on the connections between societal and economic progress—has the power to unleash the next wave of global growth.
An increasing number of companies known for their hard-nosed approach to business—such as Google, IBM, Intel, Johnson & Johnson, Nestlé, Unilever, and Wal-Mart—have begun to embark on important shared value initiatives. But our understanding of the potential of shared value is just beginning.
There are three key ways that companies can create shared value opportunities:

- *By reconceiving products and markets*
- *By redefining productivity in the value chain*
- *By enabling local cluster development*

Every firm should look at decisions and opportunities through the lens of shared value. This will lead to new approaches that generate greater innovation and growth for companies—and also greater benefits for society.

Creating Shared Value & 'Developing countries'

- Solving social problems has been ceded to governments and to **NGOs**. **Corporate responsibilities programs—a reaction to external pressure—have emerged largely to improve firms' reputations and are treated as a necessary expense.**
- **Fair trade aims to increase the proportion of revenue that goes to poor farmers by paying them higher prices for the same crops. Though this may be a noble sentiment, fair trade is mostly about redistribution rather than expanding the overall amount of value created.**
- Early studies of cocoa farmers in the Côte d'Ivoire suggest that while fair trade can increase farmers' incomes by 10% to 20%, shared value investments can raise their incomes by more than 300%.

- **Serving** disadvantaged communities and **developing countries**. Though societal needs are even more pressing there, these communities have not been recognized as viable markets.
- The societal benefits of providing appropriate products to lower-income and disadvantaged consumers can be profound, while the profits for companies can be substantial.
- **As capitalism begins to work in poorer communities, new opportunities for economic development and social progress increase exponentially.**

- **Today some companies are beginning to understand that marginalized suppliers cannot remain productive or sustain, much less improve their quality.**
- Nestlé redesigned procurement. It worked intensively with its growers, providing advice on farming practices, guaranteeing bank loans, and helping secure inputs such as plant stock, pesticides, and fertilizers. Nestlé established local facilities to measure the quality of the coffee at the point of purchase, which allowed it to pay a premium for better beans directly to the growers and thus improve their incentives. Greater yield per hectare and higher production quality increased growers' incomes, and the environmental impact of farms shrank. Meanwhile, Nestlé's reliable supply of good coffee grew significantly. Embedded in the Nestlé example is a far broader insight, which is the advantage of buying from capable local suppliers.

- **The success of every company is affected by the supporting companies and infrastructure around it.** Clusters include not only businesses but institutions such as academic programs, trade associations, and standards organizations. They also draw on the broader public assets in the surrounding community, such as schools and universities, clean water, fair-competition laws, quality standards, and market transparency.
- Stronger local capabilities in such areas as training, transportation services, and related industries also boost productivity. Without a supporting cluster, conversely, productivity suffers.

ABSTRACT

- ***In recent years business increasingly has been viewed as a major cause of social, environmental, and economic problems.***
- ***Companies: trapped in an outdated approach to value creation. They continue to view value creation narrowly, optimizing short-term financial performance in a bubble while missing the most important customer needs and ignoring the broader influences that determine their longer-term success.***
- ***Government and civil society have often exacerbated the problem by attempting to address social weaknesses at the expense of business.***
- ***Companies must take the lead in bringing business and society back together.***
- ***Shared value involves creating economic value in a way that also creates value for society by addressing its needs and challenges.***
- ***Government must learn how to regulate in ways that enable shared value rather than work against it.***
- ***Capitalism is an unparalleled vehicle for meeting human needs, improving efficiency, creating jobs, and building wealth. But a narrow conception of capitalism has prevented business from harnessing its full potential to meet society's broader challenges.***
- ***The purpose of the corporation must be redefined as creating shared value, not just profit per se. This will drive the next wave of innovation and productivity growth in the global economy.***

CORPORATE SOCIAL RESPONSIBILITY	**⇨ CREATING SHARED VALUE**
Values: doing good	**⇨ Value: economic and societal benefits relative to cost**
Citizenship, philanthropy, sustainability	**⇨ Joint company and community value creation**
Discretionary or in response to external pressure	**⇨ Integral to competing**
Separate from profit maximization	**⇨ Integral to profit maximization**
Agenda is determined by external reporting and personal preferences	**⇨ Agenda is company specific and internally generated**
Impact limited by corporate footprint and CSR budget	**⇨ Realigns the entire company budget**
Example: Fair trade purchasing	**⇨ Example: Transforming procurement to increase quality and yield**

Moving Beyond Trade-Offs

- Solving social problems has been ceded to governments and to NGOs. Corporate responsibilities programs—a reaction to external pressure—have emerged largely to improve firms' reputations and are treated as a necessary expense.
- Fair trade aims to increase the proportion of revenue that goes to poor farmers by paying them higher prices for the same crops. Though this may be a noble sentiment, fair trade is mostly about redistribution rather than expanding the overall amount of value created.
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The Roots of Shared Value

- A business needs a successful community, not only to create demand for its products but also to provide critical public assets and a supportive environment. A community needs successful businesses to provide jobs and wealth creation opportunities for its citizens.
- For the past two decades firms focused on enticing consumers to buy more and more of their products. Facing growing competition and shorter-term performance pressures from shareholders, managers resorted to waves of restructuring, personnel reductions, and relocation to lower-cost regions, while leveraging balance sheets to return capital to investors.
- Many companies no longer recognize a home—but see themselves as “global” companies.
- Companies have overlooked opportunities to meet fundamental societal needs and misunderstood how societal harms and weaknesses affect value chains.
- Managers have focused most of their attention on the industry, or the particular business in which the firm competes.
- Companies have failed to grasp the importance of the broader business environment surrounding their major operations.

How Shared Value Is Created

- Companies can create economic value by creating societal value. There are three distinct ways to do this: by reconceiving products and markets, redefining productivity in the value chain, and building supportive industry clusters at the company’s locations.

Reconceiving Products and Markets

- Society’s needs are huge—health, better housing, improved nutrition, help for the aging, greater financial security, less environmental damage.
- Serving disadvantaged communities and developing countries. Though societal needs are even more pressing there, these communities have not been recognized as viable markets.
- The societal benefits of providing appropriate products to lower-income and disadvantaged consumers can be profound, while the profits for companies can be substantial.
- As capitalism begins to work in poorer communities, new opportunities for economic development and social progress increase exponentially.

Redefining Productivity in the Value Chain

- A company’s value chain inevitably affects—and is affected by—numerous societal issues, such as natural resource and water use, health and safety, working conditions, and equal treatment in the workplace. Opportunities to create shared value arise because societal problems can create economic costs in the firm’s value chain. Many so-called externalities actually inflict internal costs on the firm, even in the absence of regulation or resource taxes.
- The new thinking reveals that the congruence between societal progress and productivity in the value chain is far greater than traditionally believed
- Today there is a growing consensus that major improvements in environmental performance can often be achieved with better technology at nominal incremental cost and can even yield net cost savings through enhanced resource utilization, process efficiency, and quality.

Energy use and logistics
Resource use

- Coca-Cola has already reduced its worldwide water consumption by 9% from a 2004 baseline—nearly halfway to its goal of a 20% reduction by 2012.

Procurement

- Today some companies are beginning to understand that marginalized suppliers cannot remain productive or sustain, much less improve their quality.
- Nestlé redesigned procurement. It worked intensively with its growers, providing advice on farming practices, guaranteeing bank loans, and helping secure inputs such as plant stock, pesticides, and fertilizers. Nestlé established local facilities to measure the quality of the coffee at the point of purchase, which allowed it to pay a premium for better beans directly to the growers and thus improve their

incentives. Greater yield per hectare and higher production quality increased growers' incomes, and the environmental impact of farms shrank. Meanwhile, Nestlé's reliable supply of good coffee grew significantly. Embedded in the Nestlé example is a far broader insight, which is the advantage of buying from capable local suppliers.

Distribution

- Unilever provides microcredit and training and now has more than 45,000 entrepreneurs covering some 100,000 villages across 15 Indian states. Project Shakti now accounts for 5% of Unilever's total revenues in India and has extended the company's reach into rural areas and built its brand in media-dark regions, creating major economic value for the company.

Employee productivity

- Today leading companies have learned that because of lost workdays and diminished employee productivity, poor health costs them more than health benefits do.

Location

- Business thinking has embraced the myth that location no longer matters, because logistics are inexpensive, information flows rapidly, and markets are global.
- That oversimplified thinking is now being challenged, partly by the rising costs of energy and carbon emissions but also by a greater recognition of the productivity cost of highly dispersed production systems and the hidden costs of distant procurement discussed earlier.
- Until now, many companies have thought that being global meant moving production to locations with the lowest labour costs and designing their supply chains to achieve the most immediate impact on expenses. In reality, the strongest international competitors will often be those that can establish deeper roots in important communities.

Enabling Local Cluster Development

- The success of every company is affected by the supporting companies and infrastructure around it. Clusters include not only businesses but institutions such as academic programs, trade associations, and standards organizations. They also draw on the broader public assets in the surrounding community, such as schools and universities, clean water, fair-competition laws, quality standards, and market transparency.
- Stronger local capabilities in such areas as training, transportation services, and related industries also boost productivity. Without a supporting cluster, conversely, productivity suffers.
- Deficiencies in the framework conditions surrounding the cluster also create internal costs for firms.
- A focus on clusters and location has been all but absent in management thinking. Cluster thinking has also been missing in many economic development initiatives, which have failed because they involved isolated interventions and overlooked critical complementary investments.
- A key aspect of cluster building in developing and developed countries alike is the formation of open and transparent markets.
- A firm's growth has multiplier effects, as jobs are created in supporting industries, new companies are seeded, and demand for ancillary services rises.
- To support cluster development in the communities in which they operate, companies need to identify gaps and deficiencies in areas such as logistics, suppliers, distribution channels, training, market organization, and educational institutions.

Creating Shared Value in Practice

- A positive cycle of company and community prosperity, which leads to profits that endure.
- It highlights the immense human needs to be met, the large new markets to serve, and the internal costs of social and community deficits—as well as the competitive advantages available from addressing them.
- Companies will make real strides on the environment, for example, when they treat it as a productivity driver rather than a feel-good response to external pressure.
- Many of the shared value pioneers have been those with more-limited resources—social entrepreneurs and companies in developing countries. These outsiders have been able to see the opportunities more clearly.

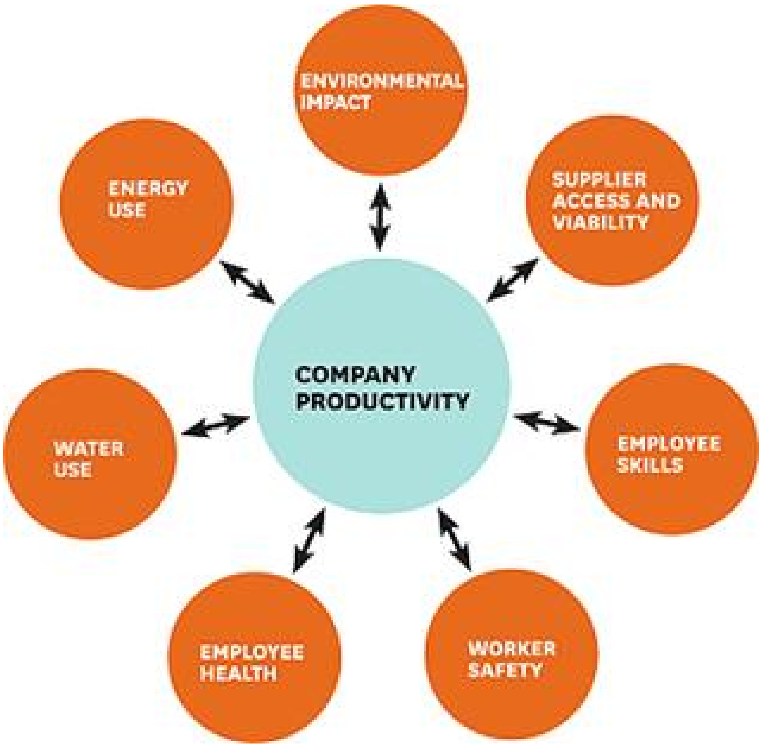
- The cycle of imitation and zero-sum competition can be broken.
- While some companies have begun to track various social impacts, few have yet tied them to their economic interests at the business level.

The Next Evolution in Capitalism

- Capital markets will undoubtedly continue to pressure companies to generate short-term profits,
- The growing social awareness of employees and citizens and the increased scarcity of natural resources will drive unprecedented opportunities to create shared value.
- We need a more sophisticated form of capitalism, one imbued with a social purpose. not out of charity but out of a deeper understanding of competition and economic value creation.
- Most business schools still teach the narrow view of capitalism, even though more and more of their graduates hunger for a greater sense of purpose and a growing number are drawn to social entrepreneurship. The results have been missed opportunity and public cynicism.
- Business school curricula will need to broaden in a number of areas. For example, the efficient use and stewardship of all forms of resources will define the next-generation thinking on value chains.
- The study of deeper human needs and how to serve non-traditional customer groups.

Blurring the Profit/Nonprofit Boundary

The Connection between Competitive Advantage and Social Issues



Creating Shared Value: Implications for Government and Civil Society

- Regulators would accomplish much more by focusing on measuring environmental performance and introducing standards, phase-in periods, and support for technology that would promote innovation, improve the environment, and increase competitiveness simultaneously.
- **The principle of shared value creation cuts across the traditional divide between the responsibilities of business and those of government or civil society. From society's perspective, it does not matter what types of organizations created the value. What matters is that benefits are delivered by those organizations—or combinations of organizations—that are best positioned to achieve the most impact for the least cost.**

- Helping small farmers increase their yields will not create any lasting benefits unless there are ready buyers for their crops, other enterprises that can process the crops once they are harvested, and a local cluster that includes efficient logistical infrastructure, input availability, and the like.

Government Regulation and Shared Value

- Regulation is necessary for well-functioning markets,
    1. they set clear and measurable social goals,
    2. set performance standards
    3. define phase-in periods for meeting standards,
    4. put in place universal measurement and performance-reporting systems,
    5. efficient and timely reporting of results,
    6. regulation will be needed to limit the pursuit of exploitative, unfair, or deceptive practices in which companies benefit at the expense of society, strict antitrust policy, for example.,

How Shared Value Differs from Corporate Social Responsibility

CSR programs focus mostly on reputation and have only a limited connection to the business, CSV is integral to a company's profitability and competitive position. **In both cases, compliance with laws and ethical standards and reducing harm from corporate activities are assumed.**

Michael E. Porter *is the Bishop William Lawrence University Professor at Harvard University. He is a frequent contributor to Harvard Business Review and a six-time McKinsey Award winner.*
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