

## EXECUTIVE SUMMARY<sup>1</sup>

Zurich, February 6, 2017

CCRS Policy Panel and Plenary Discussion

### **What does embeddedness mean in the context of corporate sustainability?**

*Thursday, 19 January 2017, 16.00 – 18.30 h  
University of Zurich, room KOL F 117, Rämistrasse 71*

#### **Abstract**

On January 19, 2017, CCRS organized a policy panel at the University of Zurich on the potential sustainability effects resulting from the commitment of multinational companies to embed themselves into the local economy and community. The policy panel consisted of a keynote address and a subsequent panel discussion with experts in finance, corporate responsibility and sustainable business on the meaning and value of local embeddedness in the context of sustainable economic development. The policy panel was organized and moderated by Isabelle Schluep, head of sustainable impact at CCRS.

#### **Context**

Swiss-based multinational companies (MNEs) face increasing public scrutiny to demonstrate that their business activities especially in developing regions comply with social and environmental regulation and follow established voluntary ethical standards. Yet, Corporate Social Responsibility (CSR) should not just be about compliant reporting. It should also recognize the potential positive effects that may result from responsible investment for the local private sector as well as the local community and the environment. In this context, the ISO 26000 guidance on social responsibility points out that companies do not operate in a vacuum. It lists their possible contributions to «community involvement and development» as one of seven core subjects to be assessed. All core subjects are directly or indirectly related to an MNE's commitment to local embeddedness while strictly abiding to its sustainability standards and principles. Embeddedness reflects how the MNE is enmeshed in local culture, social networks and institutions. In this policy panel we explore to what extent a corporate commitment to local embeddedness may generate positive sustainability effects for the local economy as well as its people and the environment. Assessed positive effects may then be deducted from assessed negative effects to capture the net-impact that MNE's may have in different industries, products, and contexts.

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## **Introductory notes**

In his opening remarks Philipp Aerni, director of CCRS, described «Sustainability» as «FuturAbility», understood as the ability of society and the economy to shape the future in a way that ensures improved socioeconomic and environmental conditions for the next generation.

In this context, an innovative and growth-oriented private sector has the potential to empower people and find sustainable and scalable solutions to widespread sustainability problems. It does so by making use of the only non-scarce resource we have on this planet, which is knowledge. By converting knowledge into new products and services that meet particular needs in society, companies generate not just returns for themselves but also positive effects for society as a whole. The Sustainable Development Goals (SDGs), approved by the United Nations General Assembly in September 2015, recognize the crucial role of the private sector in contributing to sustainable change. Especially less developed countries have learned that their sustainability challenges cannot be addressed by merely relying on foreign aid: they need foreign direct investment (FDI) that also benefits the local economy and community.

The topic is of utmost importance as Switzerland is home to many MNEs which have large FDI stocks (i.e. in the form of subsidiaries) in developing countries. In order to capture the benefits and potential positive externalities of the operations of MNE subsidiaries that are committed to socially and economically embed themselves in (developing) countries, CCRS together with different partners has launched a research project. The latter is supported by the Commission for Technology and Innovation (CTI). A toolkit is being designed to capture the extent and quality of embeddedness. This is crucial to measure the actual contribution of MNEs towards sustainable development to help create awareness in society that responsible MNEs do not operate in a vacuum and create not only private profits for themselves but welfare effects for society as a whole. Commitments by MNEs to align social responsibility strategies to benefit societies in host countries are one way to ensure their license to continued operation.

## **Key messages by Hans Jöhr, Head of Corporate Agriculture at Nestlé**

Hans Jöhr explained in his keynote address the concept of embeddedness in the context of corporate sustainability at Nestlé, how Nestlé operates and why Nestlé must have a comprehensive («helicopter») view of the world at all times. In order to ensure long-term supply of agricultural materials to serve its brands, and to be part of the solution to feed a growing world population, he emphasized that it is vital to map out and to monitor the critical issues that influence social and environmental change worldwide.

Mr. Jöhr stressed that Nestlé's long-term goal to «creating shared value» (csv), meaning not only to create value for the company and its shareholders but also to create long-term positive value for society, is key for continuity and the long-term survival of the company. Nestlé is successful whenever it is able to help upgrade its local suppliers and respond to preferences of its local customers. In other words, its embeddedness into the local economy is part of its long-term business strategy. Nestlé relies on partnerships to conduct training and capacity building of its 9'700 supply chain staff worldwide and 760'000 suppliers. Some 400'000 farmers received training in 2015. This also underscores the importance of people to Nestlé's operations and success. Mr. Jöhr points out that by pursuing embeddedness, one avoids transferring western values to other countries, as they may not be compatible with the real needs of the local population.

The company partners with over 380 NGOs worldwide to promote sustainable farming and business practices and to achieve the SDGs. These «impact relationships» with NGOs enable Nestlé to contribute to sustainability beyond its sphere of control and influence. Mr. Jöhr stresses that it is necessary to align the targets of the company with other organizations and together, share commitments to improving sustainability goals and to ensure the continuity of projects into the

future. The latter can be achieved if eventually ownership in the project is handed over to communities. This contrasts with development aid programs which have failed in the past because they were not planned to endure.

Related to ensure long-term supply of agricultural materials the company worries about how talent can be retained in agriculture, and how farmers can create additional income. The goal is to ensure that farmers in developing countries farm by choice and not by necessity. This means that farmers have a decent life, can afford health care and educate their children. To achieve for example additional income at the farm level Nestlé is using a «theory of change». It hinges upon defining all of the necessary inputs (i.e. trainings) needed to bring about the desired short (i.e. adoption rates of good farming practices) and long-term outcomes (i.e. productivity increase) and using «Key Performance Indicators» (KPIs) to measure impact (i.e. improved farm economics). The method has assisted Nestlé to standardize change to achieve sustainability impacts. KPIs are important to keep csv alive and to justify projects as they usually are the first casualty of business reorganization whenever there is an economic downturn.

### Panel discussants

Following the keynote address by Hans Jöhr, the panelists were introduced by Isabelle Schlupe, head of sustainable impact at CCRS. The panelists were asked to present what embeddedness means in the context of the company and the industry in which they are operating in.

**Ueli Frei**, President of Fundes Latinoamérica, explained the transformation of Fundes (Foundation for Sustainable Development) from a philanthropic (donation-driven) service provider to micro, small and medium sized enterprises (MSMEs) to a for-profit business by preserving the organization's social mission. A change was necessary when the benefactors of Fundes became skeptical of the charity model. The embeddedness approach facilitated the process of transforming Fundes towards a for-profit organization to supporting MSMEs. Fundes realized that if MSMEs are being part of the supply systems and having procurement arrangements with large MNEs they would benefit. Coincidentally, a similar idea by Michael Porter<sup>2</sup> on csv was timely. The organization decided to turn its focus on supply chain projects and to make procurement its core business. Fundes attracted new skills to reinvent its portfolio of services and built a business model that was market-oriented and financially self-sustaining. At the same time the organization engaged in tackling social and environmental concerns in partnership with its larger partner companies.

**Nicole Voillat**, Sustainability Director of Bata Brands SA, presented how sustainability was part of the company development since 1894. She highlighting how embedded the company is: in 17 countries and with 24 factories the company has been present already for 120 years. Most products are manufactured locally, including design and distribution. In Bolivia, Bata produces sandals for the «cholitas<sup>3</sup>» in different widths as these women have especially wide feet. In Africa, Bata has been producing and selling leather school uniform shoes for 60 years designed to last for a long time («Toughees») as many children have to walk long distances to school. Bata operates 5'700 stores in 60 countries and employs around 30'000 people who are hired locally. The company is using the SDGs to contribute to sustainable economic growth and sustainable production. Moreover, Bata targets the four billion people at the Bottom of the Pyramid (BoP). Bata has management tools for measuring and managing its impacts on sustainable development. It publishes sustainability impacts in the «Bata Life Sustainability Review» together with steps it has taken to meet the set targets.

**Christoph Müller**, chairman of the board of directors of Inrate, said that the way companies manage social, and climate issues are increasingly relevant for investors. He provided a unique insight on

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<sup>2</sup> Michael E. Porter and Mark R. Kramer (2011) Creating Shared Value. *Harvard Business Review*, January-February.

<sup>3</sup> Women wearing a hat and a skirt with several petticoats.

embeddedness by introducing the concept of materiality. What is material, he said, is the performance on social and governance issues. What an investor needs is clear information about the actual source of sustainability of a portfolio, their social and governance performance, and how it relates to financial results. An important aspect for a rating agency is to capture and measure the real contribution that accrues to local communities from companies. Measuring sustainability is hard because in addition to interactions with the natural environment it encompasses many aspects of society, economy, and institutions. Indicators can help measure key facets of sustainability to allow investors to make decisions about the best portfolios. The portfolio must reflect the positive as well as negative spillovers or social returns.

**Bilge Ogut-Cumbusyan**, managing director at Partners Group (private equity), stated that embeddedness is a second-order issue for an investment firm. It is important from a private equity perspective because a fundamental prerequisite to investing in companies is an in-depth understanding of what it is that makes a particular company successful and what will make it even more so in the future. There are two factors: the financial and the social factors. Embeddedness according to Ms. Ogut-Cumbusyan is simply about knowledge transfer. It is about bringing people with different ideas to interact and produce new solutions and approaches. It is about sharing principals and let the group turn these into rules for their companies to adopt rather than imposing rules on them. Embeddedness is ultimately about turning technologies into solutions, giving people the ability to nurture ideas and creativity to try different things by putting ideas to test.

**George Jaksch**, chairman of Biodiversity Partnership Mesoamerica, narrated his long experience as a Chiquita employee in Colombia. He observed that Chiquita's employees were the only workers in the region with pensions. Mr. Jaksch deems that to be embedded in the local environment one must first and foremost transform the personality of the organization by creating a set of values and living up to them. In other words, the real challenge lies in the achievement of consistency of conduct over time, across languages and geography and especially in a challenging and demanding situation. It applies to companies as it is to people. For example, Chiquita decided it was time to do things differently and agreed that employees should be homeowners. Having opposed labor reforms in the past, it decided to sign a framework agreement with the global trade union federation on agriculture. To date, it is the only company that has done so. These tangible steps along with a focus on the community have embedded Chiquita in many communities in Latin America.

**Roberto Vega**, head of Smallholder Policy and Food Chain Relations at Syngenta International AG, presented the scope of Syngenta's products. He pointed to the challenge that where one hectare of land fed two people in 1950, the same hectare must feed five people in 2050. To produce more food under conditions of unprecedented pressure on resources, Syngenta must support farmers to produce more sustainably because they are at the core of Syngenta's business model. For this, Syngenta had to change the way it does business. It identified priorities and committed to implementing what it calls a «Good Growth Plan» to make a measurable contribution to sustainability by 2020. The six commitments aim to improve resource efficiency, rejuvenate ecosystems and revitalize rural communities. Like Nestlé, Syngenta recognizes the enormous challenge to go it alone. It therefore works in partnership with governments, farmers, NGOs, international organizations, and academics.

## Panel discussion

Isabelle Schlupe lead through the panel discussion.

### ***How do you define sustainability?***

According to Nicole Voillat sustainability is the way the company is sourcing, buying, producing and distributing products. These activities exude a sign of Bata's respect to the planet and people. It is ultimately about minimizing the impact of Bata's products. She stressed that performance is not just about creating shareholder value but about passing wealth to the community. Though a global company, Bata has traditionally built entire towns where employees had access to housing and schools in the vicinity of its factories. Bata's 120 years of existence having survived war and nationalization is a testimony to its embeddedness and sustainability.

Bilge Ogut-Cumbusyan explained sustainability from a fund manager's perspective. Doing things just a little better is not enough. Implying the need for processes that radically transform economic structures from within. Suggesting the need for destructive solutions (creative destruction) and mainstreaming such solutions. Only then will companies invest in technologies and systems to achieve the goal of zero carbon footprints. Ms. Ogut-Cumbusyan is skeptical about setting incremental targets and KPI's to measure progress. Companies rarely excel when they are required to perform in small incremental steps because such an approach seldom induces radical change.

Christoph Müller reminded the audience that investment techniques have radically changed over the past decade. There are new business models that provide solutions to the problems that poor communities face, but we still do not know how to rate them. The question is how to compare and measure the value of these innovative investments. We also know that investing in low-income countries results in higher sustainability impacts compared to the same level of investment in a high-income country. Productivity growth is greater in developing countries. Hence sustainability impacts including jobs, clean water, and environment are higher. While investors now have many investment options, rating agencies need new data to measure financial risks<sup>4</sup> and social returns to capital of a wide variety of portfolios.

Ueli Frei considers thinking in the long term rather than quarterly or yearly reports is good for sustainability. He also points to an overall positive trait of an emerging generational change in values. The younger generation he argues expects and tends to demand more out of their jobs than just a good salary. This attitude will increasingly influence companies to adopt sustainable policies to retain or attract young talent. A social and environmentally conscious generation could tip the balance towards sustainable decisions of companies much more than CSR reporting.

### ***What are desirable and undesirable forms of local embeddedness? What are the challenges and opportunities of a corporate commitment to local embeddedness that generate local sustainability effects?***

George Jaksch began with a cautionary note that if embeddedness is about companies adapting to the local social and cultural settings, then it could be construed as an acceptance of local customs, which may include bribery, discrimination of women and minorities, and tax avoidance. It is something to watch out in countries where local laws or law enforcement are inadequate to prevent negative impacts of production practices on human health or the environment. However, the definition of embeddedness is related to sustainable behavior as well as to community conduct.

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<sup>4</sup> Financial institutions adopt a risk management framework (the Equator Principles) to determine, assess and manage environmental and social risk in projects. The principles apply to project finance (dams, power stations and mines) but not to the wider private investment portfolio. The Climate Principles is another promising framework to integrate climate change in business decisions but appears to be inactive.

Bilge Ogut-Cumbusyan explained that from an investor's perspective, it is about having a good governance model supported with transparent processes and practices. Investors like her keep away from certain industries that are perceived to be heading on an unsustainable path. Still, capital constraints can be a powerful driver for change. Unsustainable businesses that need capital could be persuaded to implement sustainability goals as a precondition to getting money. Although such guidance is useful, it may not be enough to convince her organization because they seek and get information from alternative sources before making strategic investment decisions.

Christoph Müller concurred with the notion of capital constraints and reiterated that it is increasingly material to find out whether communities are benefiting from positive externalities. Equally important is the way local stakeholders acquire technology and knowledge. Empowering the local community is a desirable type of embeddedness that adds value to the investment portfolio.

Nicole Voillat emphasized that sustainability must trickle down from top management to the shop floor. Bata is so embedded that many locals believe Bata is their national company.

***To what extent does the ISO 26000 guidance on social responsibility and especially its core subject «community involvement and development» address the sustainability effects resulting from embeddedness?***

George Jaksch believes that ISO 26000 is an excellent framework with which one can capture embeddedness. It is cleverly crafted to cover all types of businesses. It gives guidance on how businesses and organizations can best operate in a socially responsible way. Important too is the recommendation to move away from aid programs and philanthropy by providing communities with the necessary capacities to innovate and discover local solutions to address local problems. It is worth noting that ISO 26000 is a guidance framework and is not certifiable.

Nicole Voillat is skeptical about the implementation of CSR and other frameworks because of the tremendous efforts required to build internal CSR capacity to do assessments and to measure targets and sustainability outcomes. Ms. Voillat cited that seven staff members are needed to produce reports that conform to GRI guidelines. Being a non-listed company, Bata is not compelled to produce CSR reports.

Ueli Frei thinks that standards and norms like ISO 26000 or others require the right incentives to succeed. He predicts that CSR reporting like its predecessor «Total Quality Management» (TQM) in the late 1980s and early 1990s might cease to exist in the next years. Reiterating that as long as reporting is not an integral part of the mission and values of the company, reporting will not make a significant difference to change behavior. Companies must first and foremost make sustainability their core business. They will do so if that is what makes them competitive. Once a company understands its social purpose, the internal communications team should be able to relay that core message to the public. Empowering the local community is a necessary condition for embeddedness. A case in point is when the local involvement of an empowered community helped to stop a global mining company from grabbing their land.

### **Comments from the floor**

Listed companies are required to disclose in their financial report, both profits and loss, negative and positive performance. This is not the case with CSR reporting where companies disclose positive performance and withhold negative impacts. The question is whether this should change.

Another challenge to sustainability is the relation between performance and reputation. A company with a bad reputation may have transformed its operations to become a good performer. On the other hand, a company with an excellent reputation may have the worse corporate governance record. It poses a challenge to hold companies accountable. The question is what incentives are there to influence companies that are riding high on a false sense of good reputation.

## **Concluding remarks by Roberto Vega**

Roberto Vega emphasized the following aspects: The culture of a company and its business model can potentially create positive sustainability effects. However, sustainability reports seldom capture these positive externalities. Companies view embeddedness as a means to tap into local knowledge, to secure operating licenses, to gain social acceptance, to create shared value for the company and the local community and ensuring long-term profitability. Subsidiaries that build mutually beneficial relationships with local suppliers, farmers, communities and relevant stakeholders seem to do better in advancing sustainability. Embeddedness is a multi-dimensional concept, encompassing many dimensions that include social, economic, environmental, technological, political and infrastructural to mention a few. Focusing only on compliance with corporate governance standards (laws, rules, code of conduct, etc.) and certification may generate good but not necessarily better results. It was noted that ISO 26000 is non-certifiable and would not give corporations the evidence of their good performance. Linking the social and community aspects of ISO 26000 with embeddedness of firms is one way that companies can objectively show their sustainability impacts.

Small businesses can acquire sustainable revenue and grow in size by becoming part of the corporate supplier base. Partnerships and collaborations with large companies also facilitate targeted capacity building for small businesses to improve their organizational structures, management practices, and operations. This way, small businesses are enabled to bridge the gap that may exist between the standards required to enter the global market and local value chains. Overall, embeddedness allows companies to foster growth and development in the host country through transfer of knowledge and improvement of the competitiveness of the local private sector and working conditions.

## **Thank you note and further links**

CCRS would like to thank the keynote speaker and all of the panel participants for their excellent presentations and insightful inputs. Further, we would like to thank our partners for their support in the embeddedness project:

**BHP - Brugger & Partner AG** [www.bruggerconsulting.ch/](http://www.bruggerconsulting.ch/)

**Chiquita Brands International** <http://www.chiquita.com/>

**Öbu – Netzwerk für nachhaltiges Wirtschaften** <https://www.oebu.ch/de/home-5.html>

**Zürcher Hochschule für angewandte Wissenschaften ZHAW** <https://www.zhaw.ch/de/hochschule/>

**Syntenta International** <http://www4.syngenta.com/>

**Nestlé International** <http://www.nestle.com/>

**InRate AG** <http://inrate.com/>

**Commission for Technology and Innovation CTI** <https://www.kti.admin.ch/kti/en/home.html>