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POSITIVE CORPORATE CONTRIBUTIONS TO THE ECONOMIC AND SOCIAL DEVELOPMENT OF HOST DEVELOPING COUNTRIES

Note prepared by the UNCTAD secretariat*

Executive summary

This note addresses a non-exhaustive set of issues concerning corporate contributions to the economic and social development of host developing countries. As a starting point, it identifies seven areas in which transnational corporations can make contributions to economic development. It concludes with issues to be further explored with a view to stimulating expert discussion in order to identify major challenges in this area and determine the way forward.

* This document was submitted on the above-mentioned date as a result of processing delays.

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INTRODUCTION

1. In pursuit of the mandate outlined in paragraph 58 of the São Paulo Consensus, calling on UNCTAD to "carry out analytical work with a view towards facilitating and enhancing positive corporate contributions to the economic and social development of host developing countries", the Commission on Investment, Technology and Related Financial Issues, at its ninth session in March 2005, decided to convene an Expert Meeting on Positive Corporate Contributions to the Economic and Social Development of Host Developing Countries.

2. The primary contribution of corporations to development is economic in nature. To increase this contribution (and minimize possible negative effects deriving from corporate activities), Governments have pursued a number of policies, in both the host and the home country context. The role and responsibility of corporations in this regard has also been a focus of attention, including in the debate on attaining the Millennium Development Goals (MDGs).[1]

3. The classical concept of corporate responsibility (CR) involves a broad range of social and economic issues that are fundamental for the promotion of economic development, including human rights, labour rights, environmental conservation, and the fight against political and administrative corruption. These are based on internationally accepted principles and objectives, and form the benchmarks for the United Nations Global Compact (GC), which recognizes that companies can make important contributions towards achieving these important economic and social objectives.

4. At the same time, the most obvious impact of corporate activities on development lies in the economic realm. Indeed, at the core of CR lies the economic dimension, i.e. the inherent impact of firms in the economic sphere and particularly on economic development. This goes beyond corporate philanthropy, abiding by the rule of law and refraining from "bad" corporate conduct such as employing restrictive or discriminatory business practices. Companies are the main vectors of technology transfer and personnel training; they build up local and cross-border value chains; they foster employment and entrepreneurship; they engage in specialized product development; and they engage workers and entrepreneurs in these processes. In brief, while steered by their self-interest and strategic goals, without which no private effort is sustainable in the long run, corporations play a key role in the economic development process. This also holds true for transnational corporations (TNCs) that establish foreign affiliates through foreign direct investment (FDI) and, through their global value chains, maintain vast networks of linkages to businesses in developing countries.

5. Evidence shows that investment by TNCs can be an engine of economic growth in host economies. However, as UNCTAD's past research has clarified, not all investment produces the same impact on development, nor are the benefits of FDI diffused in the host economy in all cases. Moreover, there may also be adverse consequences arising from FDI, further underlining the need for adequate policies and the role of CR.

1 The important role of the private sector in achieving the MDGs has also been acknowledged in the practical plan blueprint provided by UN Millennium Project Director Jeffrey Sachs to the UN Secretary-General. In his report, Sachs outlines six areas of private sector contributions: increasing productivity and creating jobs; service delivery through public-private partnerships; responsible corporate governance and citizenship; contributing to policy designs; advocacy of the MDGs; and corporate philanthropy (UNDP 2005).

6. Companies are increasingly recognizing the central role that sustainable development plays in their long-term success: when markets grow, companies benefit from that. In many industries today, the most dynamic markets are in the developing world, and consequently a large proportion of international companies are looking to these countries for future growth opportunities. As a result, corporations may be increasingly willing to make greater contributions towards the development effort of host countries by integrating more development concepts into their business operations. Many concepts common in international business, such as "supplier development" or "market development", are closely connected to broader concepts of sustainable economic development. Furthermore, in a globalizing world economy, corporate activities in one country may also affect the success of corporate operations in another country. Some leading TNCs from different sectors have therefore made a commitment to make CR a strategic concern in their worldwide operations.

7. In order to facilitate and enhance positive corporate contributions to development, the scope of the economic and social dimensions of the CR concept need to be explored, so as to identify relevant parameters through which positive corporate contributions are, and can be better, achieved. As an initial step in this direction, this note identifies seven areas at the interface of corporate activities and economic development as initial core topics.

I. CORPORATE CONTRIBUTIONS TO ECONOMIC DEVELOPMENT

8. Companies can affect the economic development of countries in a number of ways. These include trading, the licensing of goods and services, and FDI.[2] While all of these are important, it is through FDI that companies are most closely intertwined with local economies.

9. Companies, when investing abroad, do not only transfer capital. FDI typically comes as a bundle of tangible and intangible assets that can make a contribution to development as well. When looking at the potential areas in which companies affect economic development, it therefore makes sense to analyse specifically the various channels through which FDI can make a difference.

A. Investment in developing countries

10. There is a general consensus that TNC performance can have a positive impact in reducing poverty in host developing countries. However, it is usually the poorer developing countries that are least preferred by TNCs. For example, total 2004 FDI inflows into sub-Saharan Africa, a region that contains many of the world's least developed countries (LDCs), accounted for less than 3 per cent of the world total. Similarly, it is usually the poor and deprived areas within countries that are not attractive to investors. Indeed, foreign investors stay away from economies without basic infrastructure – those with costly and unreliable roads, ports, communication systems and electricity – and low effective consumer demand. This poses a great challenge as to how to induce more investment inflows to developing countries. Various host and home country policy instruments have been used to address this problem. In addition, a number of initiatives have been launched by several development agencies, private companies and NGOs to encourage investment in developing countries. Examples include the Emerging Africa Infrastructure Fund, designed to meet the demand for upgrading and privatizing existing

2 There are a number of more indirect ways in which companies may have an impact on the economic development of countries. This could, for example, include the effects of their global advertising and image-building campaigns. These effects are, however, not further explored in this note.

infrastructure in Africa, and the Financial Deepening Challenge Fund, specifically designed to contribute to the achievement of the MDGs.[3]

11. Apart from the fact that these initiatives include the participation of TNCs, the scope of positive corporate contributions in this regard could be further explored. Issues that could be addressed in this connection concern further corporate involvement in overcoming information market failures with regard to investment and business opportunities in developing countries and corporate participation in risk mitigation schemes. To address the issue of information market failure, UNCTAD and the International Chamber of Commerce have been working for a number of years on a joint project called “Investment guides and capacity-building for least developed countries”. On the ground, this project involves a number of investors who are already present in these countries, soliciting their views on investment conditions and opportunities and reflecting them in the guides.[4]

12. Other areas of positive corporate contributions to development include the active participation of companies in public/private partnership schemes dedicated to improving the capacity of developing countries to create business-enabling environments. Such partnership schemes – sometimes involving business associations and international institutions – also exist with a view to identifying business investment opportunities in LDCs. A recent initiative was proposed under the Global Compact umbrella in Johannesburg entitled “Growing Sustainable Business in the Least Developed Countries”.[5] The joint UNCTAD and ICC Investment Advisory Council for LDCs is another example.

B. Provision of goods and services

13. Companies tend not to seek markets in developing countries with low effective consumer demand, lack of adequate infrastructure to facilitate imports, inadequate human capital to provide labour, and inadequate legal structures to provide a stable business environment. Countries can work to improve all of these factors to make themselves more attractive to international investment. But TNCs can also help by, for example, contributing towards improvements in infrastructure and human capital and reconsidering the issue of market size on the basis of alternative marketing approaches tailored to serve the "micro-purchasing" habits of developing and least developed countries.[6] Indeed, evidence is mounting that profits can be earned by creating specialized products that serve the needs of the poor in developing countries. Companies could further this development by customizing products and services to meet the needs of the poor and by further reducing their profit margins so as to provide affordable goods and services.

14. For banks or other financial services companies, an important contribution to local economies could be, for instance, to provide local entrepreneurs in developing countries with better access to commercial finance, e.g. through innovations in venture capital, micro-credit and micro-finance schemes, sustainability risk assessment, specialist underwriting of risk, and joint

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3 See http://www.emergingafricafund.com/first.htm, http://www.financialdeepening.org/.
4 Eleven guides have been published, covering 10 countries and one region (the East African Community).
5 See www.undp.org/business//gsb.
6 For example, see the broad area of research on "Bottom of the Pyramid (BOP)" marketing strategies that find value in developing country markets by adjusting to new product, packaging and distribution considerations (Prahalad 2004).

initiatives between international financial institutions and private equity firms.[7] Positive corporate contributions to development could support these initiatives, including through charging of lower interest rates and reduction of profit margins.

15. Private investment in the supply of public and semi-public goods – such as infrastructure, health care, communications – has become more widespread. However, the involvement of TNCs in public utilities is controversial (UNCTAD 2004). The main challenge in this context is the need to strengthen regulatory regimes that allow developing country Governments to maintain macroeconomic stability and promote stable and secure access of the poor to public goods and services. Corporations could contribute to achieving these aims. A case in point may be that firms should refrain from abusing any dominant market position that an investment arrangement might offer. This is particularly possible in cases of infrastructure and utilities development projects, where the provision of the products and/or services in question gives rise to a natural monopoly. In addition, given that such activities often involve the provision of essential public services, the corporate partner ought to ensure that these are offered equitably and that the public service function is carried out with due diligence.

16. As for the pharmaceutical industry, the MDGs ask companies in this industry to commit to working constructively and creatively on mechanisms – including with regard to intellectual property rights – that facilitate the provision of essential medicines to reverse the spread of illnesses such as HIV/AIDS, tuberculosis and malaria, in addition to researching into and producing new drugs. Some major pharmaceutical companies have already undertaken initiatives in this regard (box 1).

C. Employment creation, enhancement of skill levels of local workforces, and creating linkages

17. By creating employment, companies can make an important contribution to fighting poverty and promoting development (UNCTAD 1999). Employment can be created in a direct or indirect way. While direct employment creation is obvious, the more indirect impact that foreign affiliates can have on employment – through, for example, linkages with local companies – is often overlooked. Indeed, there are examples to show that multiplier employment effects can be even higher than the employment creation effect of the investment itself (ibid).

Box 1. Merck's engagement policy

Since 1987, Merck has been donating Mectizan, a medicine that helps to prevent river blindness, through a global network that includes the affected communities, the World Bank, the World Health Organization, national health ministries and NGOs. In 2004, more than 40 million people in 34 countries received free treatment. Another 20 million people received donated Mectizan to treat lymphatic filariasis in eight countries where the two diseases are co-endemic.

Since 2000, Merck has also been engaged in a partnership with the Government of Botswana and the Bill and Melina Gates Foundation to implement a comprehensive national HIV/AIDS strategy, with the company providing $50 million over five years. And since 2001 the company has provided its two anti-HIV medicines at a non-profit price in LDCs and countries hardest hit by the epidemic.

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7 Providing access to commercial finance, fostering gender-specific and innovative developmental financing approaches and supporting public/private sector financing mechanisms to benefit SMEs and small entrepreneurs in developing countries, and in particular in LDCs, are elements that are also reflected in the Monterrey Consensus.

In addition, Merck is engaged in HIV/AIDS partnerships in China and Romania, and participates in the Global Fund to Fight HIV/AIDS, Tuberculosis and Malaria and the Global Alliance for Vaccines and Immunization.

Source: Merck 2005.

18. The extent to which this happens depends to a large extent on the willingness of TNCs to integrate into the local economy and source domestically, rather than becoming an enclave by depending mostly on imported inputs. Much may depend on the ability of TNC managers to take a creative, and case-specific, approach to sourcing decisions, and to go beyond relying on existing supply networks used by the TNC, whether located in other affiliates or existing subcontractors. Indeed, one important channel for increasing local value-added and employment is through the forging of supplier linkages with domestic companies. There are many examples of big as well as smaller TNCs successfully pursuing a proactive approach towards increasing the share of local value-added in their production (UNCTAD 2001). This includes a strategic approach to increasing the level of technological sophistication of the production carried out in developing countries and the training of local employees so as to enable them to carry out more skill-intensive (and more highly paid) activities over time.[8] Linkages with local businesses can also help the latter to explore new export or product markets. Accordingly, the development of supply chains may not only benefit the foreign affiliates but also increase the productive and export capacity of host countries.

19. Obviously, the impact companies can have in these areas depends on the nature of the investment (with the likelihood of linkage creation being higher in domestic-market-seeking FDI than in export-oriented FDI) and on the quality of the local suppliers. Strengthening of local supplier capabilities is indeed crucial in this regard, and it is here that positive corporate contributions to development could unfold – tapping into, and proactively developing, the potential of local supplier linkages (UNCTAD 2001). A number of success stories can be identified, and it appears important that best practices in this regard be as widely disseminated as possible (box 2). Sharing of best practices is one of the aims of UNCTAD's business linkages programmes in Brazil and Uganda. To promote the creation and strengthening of sustainable TNC-business linkages, this programme also provides policy advice on improving the environment for sustainable business linkages and helps in identifying business linkage opportunities.

Box 2. Nestlé's supplier development in China

Packaging supplier linkage development. Nestlé operates 18 factories in China with a turnover of CHF 1 billion in 2000. Already in 1994, Nestlé decided to engage in active supplier development to meet its high local packaging requirements, and, by 1997, it was covering 98 per cent of its needs from local suppliers. Nestlé's approach of developing local suppliers is pragmatic and directed to concrete needs. The company worked with local suppliers to help them meet quality standards by providing information, technical assistance and sometimes also financial support. Its efforts to establish proper quality control also contributed to the competitiveness of local suppliers, who now export to the Russian Federation and the Republic of Korea.

8 The impact that companies can have in these areas also depends largely on respect for labour and social rights, as reflected in the ILO standards that are part of the 10 core Global Compact principles.

Raw material supplier linkage development. In 1991, Nestlé established a Nescafe factory in China. For the first two years of operation, this factory imported all green coffee needed for production. To facilitate a switch to local suppliers, Nestlé set up an Agricultural Technical Assistance Service (ATAS) to promote the cultivation of coffee through the provision of technical advice and facilitation services. Later it also created a Professional Training Department to provide technical and practical training to those responsible for growing and selling coffee, agronomists and civil servants, and individuals interested in entering the business. In addition, some agronomists have been trained as trainers. As a result, Nestlé today purchases large quantities of coffee from Yunnan (about 3,000 tons in 2002), thus providing a steady income to local coffee farmers.

Source: UNCTAD 2001.

D. Technology transfer

20. The competitive advantage of TNCs from developed countries often stems from the possession of superior process or product technology that at the same time is a key ingredient to economic development (as acknowledged in the MDGs). When doing business with partners in developing countries, TNCs may have the choice of either sharing their technology or keeping it for themselves. The latter option is often more appealing, as it is this technological edge vis-à-vis other companies that may ensure success. There are, however, ways in which TNCs can contribute to the technological upgrading of local companies and the local economy as such without the risk of key technologies leaking to competitors. Again, the extent to which a company is willing to cooperate with local suppliers determines the development impact it will have in this area. Positive corporate contributions to development could include technical support to domestic supplier firms to help them master new technologies, including through assistance in production planning, quality management, inspection and testing, collaboration in R&D (UNCTAD 2005), sharing information and extending financial support, including through assistance to employees to set up their own firms (UNCTAD 2001).

E. Ethical business behaviour

21. Companies (domestic and foreign alike) should abide by the laws of the countries in which they operate and refrain from unethical business practices. This refers to such issues as not taking advantage of weak law enforcement, anticompetitive practices and corruption. Anti-competitive practices, such as colluding with other firms to control markets, abusing transfer pricing, or engaging in corrupt practices to gain unfair advantages, can all be significantly detrimental to local firms, local employment and the general economic development prospects of a host developing country. Responsible TNCs may be expected to go beyond the local law to meet important needs of host developing countries where legal norms relating to good corporate citizenship may be absent or underdeveloped.

F. Contribution to public revenue generation

22. TNCs are taxpayers in developing countries and provide contributions to public revenue generation. Their taxes and other dues are crucial for Governments that on the one hand may face enormous tasks in areas such as social systems or upgrading of public infrastructure, while on the other having only a fraction of the resources of developed country Governments to tackle these problems. Whether or not companies pay taxes properly (and for example do not engage in abusive transfer-pricing manipulation) can have an important impact on a country’s ability to alleviate its development problems. TNCs are thus expected to abide by a country's tax law and to meet their tax obligations in good faith. Corporate responsibility in this regard could, for

example, encompass cooperation with the tax authorities of host countries and the provision of appropriate accounting data and tax reconciliation records for tax inspections when required (UNCTAD 2003).

G. Minimizing negative effects of business restructuring

23. Firms exit from a market due to business strategy adjustments. This leads to undesirable effects in host countries, developed and developing alike. Creating conditions (including in terms of time) that enable the economy to adjust is one of the challenges that arise out of these circumstances. TNCs could proactively engage in the mitigation of such negative effects, including through special measures to minimize the local economic impacts of plant closures and significant staff reductions.

II. THE ROLE OF POLICY

24. Issues related to the development impact of TNC activities have been part of the development debate for decades and are the subject of various national and international policies. Mandatory (e.g. performance requirements), inducive (e.g. incentives) and hortatory (e.g. voluntary guidelines) approaches to increasing corporate contributions to development have been pursued at various times, in various circumstances and with various degrees of success.

25. The role of the private sector in development, including that of FDI, has been stressed in the Monterrey Conference on Financing for Development, the Doha Development Agenda, the Johannesburg World Summit on Sustainable Development and, most recently, the São Paulo Consensus of UNCTAD XI, which states that:

> "*… corporate actors have a positive role to play in stimulating the economic development of host countries and in supporting social and environmental development and the competitiveness of local enterprises. There are various voluntary international instruments that could be improved and made more coherent, covering economic, social and environmental dimensions, to help increase the contribution of corporate actors, especially TNCs, to the advancement of development goals.*" (TD/410, 25 June 2004, paragraph 45).

26. In sum, an international consensus is in the process of being formed from these recent conferences that might provide the nucleus for a definition of the role of business, including TNCs, in contributing to economic development, as already exists for the areas currently covered in the Global Compact.

III. ISSUES TO BE ADDRESSED BY THE EXPERT MEETING

28. Companies can make a difference to the economic development of their host countries in many areas. No complete inventory exists that lists and defines all possible channels through which business can make a contribution to economic development. For the fight against poverty, it is important to be clear about which contributions each of the important players – host and home country Governments, international organizations and firms – can make. For companies, it is important, in their own interest, to support the development effort, as developing countries are increasingly important future markets. For developing countries and international organizations

such as UNCTAD, it is important to identify areas of synergies and cooperation in the struggle to fight poverty.

29. In light of the above, experts may wish to explore a number of questions:

- How should the "economic dimension" of CR be defined? What are the possible issues regarding the positive corporate contribution to the development of host developing countries? Which among them require immediate attention and action?
- What are the forces driving companies to contribute to economic development? What can be done to enhance the economic contribution of TNCs to a local economy? What are the impediments?
- Are there real-world cases that could be drawn upon as models for successful promotion of TNCs' contribution to local economies from the above-identified areas?
- What is the role of national policy, both from a home and a host country perspective, in facilitating and enhancing positive corporate contributions to the development of host countries? What is the role of the international community in this regard?
- What is the role of corporations, business and industry associations?
- What are the lessons that can be learned from the area of corporate social responsibility, both in terms of approaches and in terms of disseminating best practices?

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