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Feature

Cocreating Business's New Social Compact

The liberalization of markets is forcing executives and social activists to work together. They are developing new business models that will transform organizations and the lives of poor people everywhere.

by Jeb Brugmann and C.K. Prahalad

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In early 2005, we met privately with the chairperson of one of the world's biggest banks to discuss business opportunities in catering to poor people. The chairperson responded bluntly. "We don't care about making profits [on such a business]," he said, with the bank's CEO sitting beside him. "There's something even distasteful about the idea of making money off people who earn less than \$1 a day." He raised a related issue that, unexpectedly, became the topic of our discussion that morning: how the bank could create, manage, and scale up a program to support elementary schools for poor children in a certain developing country. We were a little surprised that a banker was so preoccupied with a problem that usually keeps not-for-profit, nongovernmental organizations (NGOs), rather than large corporations, up at night.

A week later, we spent a day with representatives of three relatively small NGOs in India. One specializes in infrastructure development and postdisaster reconstruction. Another focuses on the cultivation and processing of herbal medicines. The third provides business support to rural enterprises. Together, the three organizations also manage several self-help savings and loan groups involving around 50,000 women. The NGOs and their business advisers, some of them executives working for a large global company, wanted our help in deciding which businesses to set up. They had conducted research and market tests on opportunities in the financial services and insurance, construction, consumer products, and health services industries. By the end of the day, the NGOs decided to go ahead with three businesses: selling insurance products, retailing groceries, and providing sanitation facilities to people whose income is around 50 cents a day. We were impressed by the NGOs' desire and readiness to organize local communities so they could manufacture and sell products in the marketplace—just like good entrepreneurs.

Those two meetings, we're convinced, captured more than a fleeting role reversal; they symbolize an enduring shift in the practices of corporations and social groups and,

perhaps, in their attitudes toward each other. That may sound like a startling claim. Since the protests against globalization at Seattle and Davos in the late 1990s, people have assumed that the gulf between the private sector and the civil society, as the media call NGOs, has been growing. After all, despite social groups' protests, more countries have opened up to foreign investment, and governments have continued to privatize industries. Meanwhile, companies, especially Western multinational corporations, have come under a dark cloud. Their recent shenanigans—fraud at Enron, insider trading at WorldCom, and inept governance at Hewlett-Packard, not to mention a rash of social, environmental, and health-related controversies at blue-chip companies such as Nike, Shell, and McDonald's—have led to a near crisis of confidence in the role of the modern corporation in society.

However, a countertrend has emerged. Over the last five years, some corporations have started to pay attention to customers at the bottom of the economic pyramid. As the pioneers move into inner cities and villages, their middle managers are spending more time than you might imagine on acquiring local knowledge, value engineering, developing low-cost business models, and community-based marketing. Meanwhile, several NGOs have set up businesses to provide jobs and incomes in order to free people from the tyranny of poverty. Product development, logistics, project management, and scaling techniques are some of the mechanisms they're using to kick-start socioeconomic development in long-neglected communities.

Realizing that they each possess competencies, infrastructure, and knowledge that the other needs to be able to operate in low-income markets, companies and NGOs are trying to learn from and work with each other. For example, Danone has set up a joint venture with Bangladesh's Grameen Bank to manufacture and sell bottom-of-the-pyramid dairy products. Microsoft has tied up with the NGO Pratham to deliver personal computers to Indian villagers, while Intel and two large Indian information technology firms, Wipro and HCL Infosystems, have launched the Community PC in partnership with other NGOs to do the same. Nestlé has joined hands with health professionals and NGOs in Colombia, Peru, and the Philippines to deliver educational programs on nutrition and nutritionally fortified food products to the poor.



The Three Stages in the Convergence Between the Corporate Sector and the Civil Society

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As their interests and capabilities converge, these corporations and NGOs are together creating innovative business models that are helping to grow new markets at the bottom of the pyramid and niche segments in mature markets. These models, we believe, will lead to novel frameworks that can renew the corporation's social legitimacy even as they allow for sustainable development and accelerate the eradication of poverty. This convergence is making it imperative that managers in both sectors understand the opportunities and risks in working together.

Liberalization's Unexpected Consequences

Companies and NGOs have arrived at the same place by different routes. Over the last two decades, as many countries opened their economies to foreign competition, often at

the behest of the International Monetary Fund and the World Bank, business and the civil society fought bitterly. At first, both sides battled vociferously and publicly with governments over the need for, the nature of, and the pace of economic reforms. While companies, especially multinational corporations, wanted governments to reduce tariffs sharply and allow foreign investment into every sector immediately, the civil society argued that liberalization should take place slowly and only in some industries. Then, as governments softened labor, environmental, and investment regulations to attract foreign investment, the two sectors waged a shadow war over the reforms' future. Finally, as governments played less and less of a regulatory role, corporations and NGOs fought each other directly, debating the boundaries within which socially responsible corporations should operate. Those battles led to three unanticipated consequences.

First, NGOs emerged as the corporate sector's de facto regulators, occupying the vacuum that governments were leaving behind. They aren't newcomers to the task; for many years, NGOs have influenced markets in areas such as chemical regulation, oil spill liability, air emissions, liquid waste, pharmaceutical and food standards, child labor, and employment discrimination. Their influence has created a regulatory framework tougher than the legal requirements corporations face. NGOs may be small, but through the Internet, even a single person or organization can coordinate "smart mobs," as Howard Rheingold calls them in his 2002 book of the same name, allowing NGOs to mount actions on several fronts simultaneously. For instance, local NGOs attacked the Coca-Cola Company over its use of water in the village of Plachimada in Kerala, India. As accounts have spread from Web site to Web site, the dispute has grown into a worldwide battle over the brand's presence in universities and schools. The escalation of the campaign from market to market and from issue to issue has, as the *Wall Street Journal* wrote, cost Coca-Cola "millions of dollars in lost sales and legal fees in India, and growing damage to its reputation elsewhere."

By publicly inflicting harm to a market leader's reputation, which eventually forces the entire industry to change its practices, the civil society is often successful in getting corporations to conform to its norms. For instance, NGOs' attacks on Nike for violating human rights, on Merck and GlaxoSmithKline for enforcing patents on AIDS medicines, and on Monsanto for introducing genetically modified seeds forced the apparel, pharmaceutical, and agribusiness industries to develop new strategies and rewrite their codes of conduct.

Second, companies have invested heavily to develop expertise to cope with NGOs. They have spent time and money launching countercampaigns to protect their reputations. At first, they did so defensively, using social marketing slogans in advertisements and setting up nonprofit entities with which they maintained arm's-length relationships. Over time, they developed more proactive strategies. Smart corporations, for instance, have learned to take their case directly to consumers. They have developed corporate social responsibility (CSR) initiatives, voluntary self-regulation schemes, and cause-based marketing programs. More recently, they have launched public-interest-cum-advertising campaigns, such as Chevron's on global energy issues and Unilever's on women's beauty, self-esteem, and eating disorders. To run such programs, companies have hired people from the social sector who can bring their networks, credibility, and understanding of NGOs into corporations. For instance, Microsoft's director of community affairs worked with NGOs, the World Bank, and a social venture-capital fund for more than 20 years before joining the software giant. Some corporations are even competing

with social groups. By launching coffee, tea, and confectionary products with a guarantee that disadvantaged producers are getting a better deal, for example, North American and European manufacturers and retailers are competing with Fairtrade Labelling Organizations International, which enforces its standards on NGOs and member companies.

Third, markets are emerging as an arena in which companies and NGOs interact. Liberalization has provided corporations with access to new consumers, but reaching low-income customers is difficult nonetheless. Executives have to invent new business models if they are to succeed in those markets, and they often find that NGOs possess the knowledge, local infrastructure, and relationships necessary to make them work. There are NGOs that have created large distribution networks that can furnish food, medicine, and credit, especially in remote areas. They have developed a deep understanding of local cultures and consumption habits. And they have established credibility and earned people's trust by repeatedly assisting disadvantaged communities in the face of poverty, natural disasters, and conflicts. Companies are beginning to work with such organizations to break into new markets. For instance, Telenor has teamed up with Grameen Bank to sell cellular telephones to rural consumers. Telenor has taken advantage of the bank's knowledge of rural microcredit groups' collection and payment system to set up a joint venture, Grameen Phone, in which it has a 62% equity stake. Similarly, World Diagnostics found that, in Uganda, it could best sell its HIV, STD, and malaria test kits through NGO-operated health care networks. The NGOs are helping villagers deal with AIDS, and they have trained medical personnel, set up clinics, and earned the trust of Ugandans along the way.

At the same time, declines worldwide in public spending on social programs have forced NGOs to review their traditional poverty reduction strategies. Where NGOs once saw government aid and private sector charity as the only ways out of poverty, they now see entrepreneurship, too, as a viable approach. They've reframed the poor as "undercapitalized, unappreciated, and undersupported entrepreneurs," and redefined poverty as a problem of "livelihoods development." NGOs such as Care developed this livelihood-oriented approach, providing poor people with training, credit, and collective business infrastructure. Consequently, social groups have discovered business opportunities among their constituents, and scores of social venture capital funds have emerged to support this strategy.

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Thus, while companies have discovered the importance of NGOs as paths to markets, social groups have realized that carefully calibrated business models can unleash powerful forces for good. Their interactions have created new links between business innovation and social development. As we shall see in the following pages, companies and NGOs are increasingly going into business together, pursuing scale and profits, social equity, and empowerment as part of an integrated value chain.

The Path to Convergence

Sometimes the best way to understand the future is to look back. When we do, we can see that the relationship between companies and NGOs is moving beyond an adversarial stance toward partnership through systematic, if uncharted, steps. This journey has so far progressed through three phases, each of which has had its teething problems, naysayers, tensions, and benefits.

The be-responsible stage. By the late 1980s, companies and NGOs realized that they couldn't keep fighting; they had to find ways of living with and influencing each other. Some felt they could take the risk of working with the other side to meet specific, albeit limited, objectives. That was the most difficult step; executives and activists had to reexamine perceptions and biases. They had to evaluate the risks to their identities, to their missions, and to their industry standing before they could collaborate with "the enemy."

"Corporate social responsibility" has become a catchall phrase for the ways by which businesses manage reputations and strike relationships with the social sector. Businesses use their resources to work on socially relevant issues as they are defined by NGOs, but most CSR initiatives, such as Exxon Mobil's involvement in the distribution of mosquito nets in Tanzania or General Motors' management of children's education programs in the United States, are unrelated to the companies' core business activities. Some NGOs are willing to work with companies to establish policy dialogues and social programs, but they keep their corporate supporters at arm's length. The pros and cons of CSR have been explored elsewhere (see, for instance, Allen L. White's 2005 report, "Fade, Integrate or Transform: The Future of CSR"), but what is relevant to our story are three convergences that it created:

The convergence of standards of practice and the emergence of joint regulatory frameworks. As companies built relationships with NGOs, the two sides adopted joint regulatory schemes. The civil society and the corporate sector together manage, for instance, the Apparel Industry Partnership, the Forest Stewardship Council, the Marine Stewardship Council, and the Kimberley Process (in the diamond business), which stipulate social and environmental practices in their respective industries. Through these mechanisms, companies have gained access to NGOs' knowledge about local markets and social networks, while social groups have developed more expertise in marketing and specialized business practices.

The convergence of brands, marketing, and communications, and the emergence of the first joint platforms for marketing and customer management. Cause-related marketing captures this trend best. That's when a company markets its products or services to an NGO's loyalists, and the NGO markets itself to the company's customers and employees, generating revenues for both the company and the NGO's charitable activities. In 2005, cause-related marketing initiatives provided around \$1 billion to social causes in North America alone. The approach has enabled the two sectors to learn each other's marketing tactics. Now, for instance, some companies use viral-marketing techniques, which NGOs pioneered, while several social groups commission professional advertising firms to design advocacy campaigns. Through such joint-marketing relationships, companies and NGOs have shifted from constructing divergent messages for polarized audiences to creating similar messages for a common audience.

The convergence of professional cadres and career paths, and the emergence of

management professionals dedicated to working with companies on social causes and with NGOs on business endeavors. Today, the human rights manager (at Monsanto), the senior manager for corporate responsibility (at Nike), and the sustainable development manager (at Marks and Spencer) work with counterparts at NGOs like the vice president for private sector partnerships at Conservation International. Once, activists would have labeled NGO professionals as sellouts if they went to work with companies, but NGO veterans now hold the communications, community relations, and market development portfolios at several companies. Executives who previously would have signaled their early retirement if they took positions at NGOs find themselves among a cohort of social venture capitalists. In fact, many managers are building their careers by moving back and forth between the two sectors. (We describe the implications of these areas of convergence for the next phase of partnership in the exhibit "How Companies and NGOs Find Common Ground.")

How Companies and NGOs Find Common Ground

CONVERGENCE AREA	EXAMPLES	CHALLENGES AND INNOVATIONS	
		CORPORATE	NGO
Pooling knowledge, competencies, and relationships to build new operating standards and coregulatory schemes.	<ul style="list-style-type: none"> > The Apparel Industry Partnership > The Forest Stewardship Council > The Marine Stewardship Council > The Kimberley Process 	The Challenge	
		To move from adhering to individual company standards to compliance with industry-wide standards.	To move from spearheading antibusiness campaigns to creating, promoting, and jointly administering standards.
		Innovative responses	
		Companies are <ul style="list-style-type: none"> > Defining standards through negotiations with NGOs. > Building the ability to participate in global and local NGO networks, forums, boards, and so forth. 	NGOs are <ul style="list-style-type: none"> > Defining standards through negotiation with companies. > Learning to understand microlevel industry operations in, for example, forestry, fishing, and mining.
Leveraging each other's credibility and social networks to create access to markets and brand value.	<ul style="list-style-type: none"> > Companies have set up cause-related marketing as a new area of specialization. > In 2005, companies spent \$1 billion in North America on cause-related marketing. 	The Challenge	
		To redefine NGOs as consumer clusters that require special messages and management.	To professionalize brand management.
		Innovative responses	
		Companies are <ul style="list-style-type: none"> > Adopting NGOs' marketing approaches, such as viral marketing. > Delivering on special brand promises. > Shifting from a reactive to a proactive approach to social sector communications. 	NGOs are <ul style="list-style-type: none"> > Cobranding campaigns with companies. > Marketing themselves to corporate partners' customers and employees, instead of making appeals to the public. > Facing stricter fiscal controls to separate economic decisions from policy decisions.
Creating professional development norms and management roles to facilitate coordination between the two	<ul style="list-style-type: none"> > Rather than two distinct camps and career paths, companies and NGOs recruit staff from each other. 	The Challenge	
		To integrate CSR into business decision making.	To cooperate with companies in some forums and disagree in others.
		Innovative responses	
		Companies are	NGOs are

coordination between the two sectors.	<p>staff from each other.</p> <ul style="list-style-type: none"> > The two sectors use a common service industry—the same marketing or law firm, for instance. > A plethora of bisector training forums, including social sector MBA programs, are born. 	<p>Companies are</p> <ul style="list-style-type: none"> > Aligning strategies for building material assets and reputations. > Integrating social and financial reporting. > Managing cooperation with NGOs in cause-related marketing and public-policy forums. > Encouraging managers to sit on NGO boards and granting leaves of absence to managers doing social sector work. 	<p>NGOs are</p> <ul style="list-style-type: none"> > Creating organizations that seek common ground on policy issues, and facilitate partnerships, with companies. > Integrating activist and business management mentalities into the organization. > Establishing new professional norms related to nondisclosure of sensitive corporate information.
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Broadly speaking, CSR started as a way for companies to gather intelligence about NGOs and manage their reputations, and it has wound up providing them with the tools they need to pursue business opportunities in untapped markets. For NGOs, CSR began as a means of persuading companies to change their ways, and it has become a means for them to develop the competencies and confidence to go into business themselves. CSR therefore laid some of the foundations on which corporations and social groups each started experimenting with new business models.

The get-into-business stage. After more than 15 years of globalization, transnational companies have made headway in only the most affluent segments of the developing world. As a percentage of GDP, for example, flows of foreign direct investment to developing countries in Asia and Latin America were no greater in fiscal 2004 than they were in fiscal 1995. These miniscule inflows signal the failure of multinational corporations to change their business models to serve the largest consumer segment in the world: the 4 billion to 5 billion consumers at the bottom of the pyramid. Barring a few exceptions in the telecommunications and fast-moving consumer goods industries, Western companies have performed poorly in serving these customers. For instance, multinational water companies, even in supportive environments like South Africa, have all but given up trying to manage urban water systems. The food-retailing industry operates approximately one store for every 3.4 million people in low-income countries compared with one store per 5,800 people in high-income countries, according to CIES, a food industry trade association based in Paris. Foreign insurance giants have failed to create customer bases in low-income markets. The list of failures and near failures is long.

When companies have succeeded in bottom-of-the-pyramid markets, we found, they have most often done it by leveraging the competencies, networks, and business models that were developed as part of their CSR initiatives or by NGOs. ABN AMRO has entered the microfinance business in Latin America with some help from the NGO Accion International. Barclays has built a successful microbanking operation in Ghana in partnership with 4,000 indigenous moneylenders and their national association. The Shell Foundation has worked with environmental NGOs to test new designs and models for delivering clean and renewable energy to underserved populations. It has created venture capital funds that support local entrepreneurs and integrate them into Royal Dutch Shell's supply chains.

Pick 'n Pay, one of South Africa's largest retailers, started a CSR initiative in the early 1990s to support struggling black farmers and their weak cooperatives, who were left on the edge of financial viability by apartheid. The foundation helped strengthen the cooperatives by providing them with management and marketing skills. When apartheid ended in 1994, Pick 'n Pay immediately started exploring how it could serve people in urban townships. The retailer found that there was an opportunity in providing those consumers with produce that came from their rural homelands. To meet that demand, Pick 'n Pay used the relationships its foundation had struck to develop reliable suppliers of traditional produce. Later, Pick 'n Pay used the same approach to create another supply chain for organic produce. (For more examples, see C.K. Prahalad's *The Fortune at the Bottom of the Pyramid: Eradicating Poverty Through Profits*.)

At the same time, social groups have also set up businesses, usually entering market segments where corporations had been unsuccessful. In 1992, the amount NGOs gave out in development assistance was equal to about 11% of the funds governments in developed countries donated; by 2003, that amount had risen to 16%. In that year, grants from NGOs represented a remarkable 9.4% of public and private development assistance from OECD countries and multilateral agencies, according to the OECD's "Development Co-operation Report 2005." NGOs have used their funds to develop the infrastructure needed to supply people in remote areas with food, medicine, other supplies, and credit when disasters strike. Along the way, they acquired firsthand knowledge of underserved markets and gained credibility with local communities.

For instance, after the 2004 tsunami, NGOs in India built microcredit operations as part of the relief effort. In Africa, international NGOs such as Africare and Direct Relief International, together with local groups, built infrastructure to deal with AIDS, famines, and refugee influxes. Along with microcredit and mutual insurance operations, they developed informal networks of traders and state-owned organizations into cooperatives, federations, and export-oriented enterprises. In India, NGOs like the Self Employed Women's Association (SEWA) are working with Indian insurance companies (such as ICICI Prudential), savings and credit cooperatives, and mutual health associations to sell insurance products. In Africa, supported by Western NGOs like Care and Finca International, local NGOs such as L'Association pour le Développement de la Région de Kaya (ADRK) in Burkina Faso, the Malawi Union of Savings and Credit Cooperatives, MicroSave (in Kenya), and Fautière des Unités Coopératives d'Épargne et de Crédit du Togo are selling crop, rain, life, asset-loss, widowhood, health, personal accident, and maternity insurance products to low-income consumers. In Uganda, Microcare has completed a three-year pilot that caters to 3,000 people. The project is being commercialized by a new for-profit company, Microcare Health, which has been set up jointly by Microcare and the Chicago-based insurer Aon.

Some NGOs are positively thriving where state-owned or multinational companies have failed. Two years ago, when the Indian insurance giant, Life Insurance Corporation, found it difficult to collect premiums and pay claims in rural areas in the state of Andhra Pradesh, microcredit federations took over the business. Their extensive knowledge of customers and their superior reach allowed the NGOs to grow the market rapidly. They operate quite profitably, earning an average gross margin of 27%.

As the scale and sophistication of their businesses grow, NGOs have become powerful national players. For instance, in 1986, a small group of street traders formed the

African Co-operative for Hawkers and Informal Businesses to fight for their rights. ACHIB today counts 120,000 members in South Africa. It advocates hawkers' interests on policy matters and provides them with support services, such as warehousing infrastructure, bulk procurement, product distribution, microloans, and training. Recently, ACHIB launched a soft drink brand called Hola, which it distributes through a for-profit entity, Main Market Distribution. The cooperative has also entered the advertising business by launching hawkers' stalls with spaces that big companies can rent, in its words, "to increase awareness for their brands in the informal market."

The Minneapolis-based HealthStore Foundation represents a new breed of nonprofit that is designed from its inception to operate as a business. The foundation was set up by a small group of business professionals who had worked with NGOs in Africa to provide people with safe medicines. It used a franchise model to create 68 owner-operated Child & Family Wellness Shops, which sell health services and medicine in small towns in three districts in Kenya. The outlets operate according to common performance standards, and the HealthStore Foundation provides them with turnkey management systems and support, training owners and helping them select locations that will allow them to serve at least 5,000 households. In 2005, the clinics treated 404,000 patients; buoyed by their success, the NGO plans to set up 30 more outlets in 2007. In addition to private donations, foundation grants, and social venture capital funds, HealthStore also accepts grants from companies.

Some NGOs, like Accion, have succeeded in building multinational businesses. Acting as an agent for large microfinance NGOs, Accion has loaned \$9.4 billion to 4 million people in 22 countries, with a historical repayment rate greater than 97%. In 1992, Accion helped create the first bank in the world dedicated solely to microenterprise—BancoSol in Bolivia. Several of Accion's partners have made the transition from being charity-dependent organizations to becoming banks or other regulated financial institutions. Accion has also helped commercial banks—such as Sogebank in Haiti, Banco del Pichincha in Ecuador, and Banco ABN AMRO Real in Brazil—lend to the self-employed poor. In the United States, Accion has worked with Bank of America and Wachovia to identify potential clients who do not meet standard lending requirements.

The growing strength of NGO-owned businesses in emerging markets is mirrored in developed countries. Nonprofits have been pioneers in trading carbon emissions, producing organic foods, manufacturing herbal supplements, providing pay-as-you-go car-rental services, and many other businesses. For example, Local Sustainability is an Ontario-based NGO that provides engineering and energy management—consulting services to municipalities. It has succeeded where the likes of GE Capital, Philips Utilities, and Ameresco have struggled, owing to the high costs involved in getting political, bureaucratic, and technical representatives of municipalities to invest in making facilities more energy efficient. Through its expertise in generating political commitment for energy and environmental measures, Local Sustainability has been able to land 36 municipalities in Canada and the United States as customers. In the process, it has generated \$2.5 million in revenues and earned a 50% gross margin. Rivals initially criticized the NGO, claiming its not-for-profit status was a public subsidy, but consulting firms such as CH2M Hill now work closely with Local Sustainability because of its skills and reputation.

Before we describe the third stage of company-NGO relations, we must point out that

the drive to set up businesses has created tensions within the two sectors. First, both companies and social groups are finding it difficult to manage their new roles. What does a multinational corporation such as Royal Dutch Shell do with the Shell Foundation when it shifts to a “business investment strategy in order to achieve both social and investment goals?” Will an NGO like Local Sustainability better achieve its objective of making facilities more energy efficient by spinning off its consultancy as a for-profit operation or by managing it as a project within its nonprofit structure? The answers aren't clear.

Second, NGOs are often unsure whether a company is a potential collaborator or competitor, and vice versa. On the one hand, nonprofit ventures such as Local Sustainability in Canada and microinsurance networks in India are bagging customers that corporations would dearly love to have. On the other hand, health food retailers such as Whole Foods Market have taken away customers who used to shop at NGO-owned cooperatives. Retailers like Starbucks and Tesco sell products that compete with the NGOs' Fairtrade line of products. Since the companies buy fewer Fairtrade products as result, the turn of events is worrying to the NGOs that created the standard.

Reactions to competition at the bottom of the pyramid can be complicated. ICICI became the biggest manager of microcredit operations in the south Indian state of Tamil Nadu by co-opting the women's microcredit groups that NGOs developed. Many NGOs are resigned to this; ICICI offers a larger range of banking services and provides greater opportunities for entrepreneurs. However, other groups are unhappy that ICICI has taken over their role and the women's self-help groups that they had designed for broader social development purposes. Some are reluctant to forge business relationships with the bank as a result.

The cocreate-businesses stage. As more companies conduct business experiments in bottom-of-the-pyramid markets and NGOs' business acumen evolves, they are realizing each other's limitations and strengths. This has laid the foundation for long-term partnerships between the two sectors based on “cocreation.” Cocreation involves the development of an integrated business model in which the company becomes a key part of the NGO's capacity to deliver value and vice versa. Such ventures offer three opportunities:

- To deliver products at low prices to low-income consumers or to provide niche products to consumers in mature markets.
- To create hybrid business models involving corporations, NGOs, and entrepreneurs at the bottom of the economic ladder.
- To revive the corporation's social legitimacy while expanding the NGO's impact.

When companies and NGOs innovate together, the commercial nature of the relationship and their roles can vary, but the outcome is often a breakthrough. In fact, this quiet dialogue, away from public debates, has spawned key principles that will underlie governance structures in the future, as the exhibit “The New Rules of Company-NGO Engagement” shows. Take the case of BP (formerly British Petroleum), which set out to develop a fuel-efficient stove for poor consumers in rural India. Market research showed that consumers wanted the option of switching fuels based on their current income, the

availability of fuels, and cooking styles. Working with the Indian Institute of Science in Bangalore, BP developed a portable stove that could use either liquefied petroleum gas (LPG) or biomass as fuel. To meet an additional social objective, BP designed the stove to burn biomass very efficiently, which would eliminate the smoke that causes respiratory illnesses in India.



The New Rules of Company-NGO Engagement

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One of BP's major challenges is distribution and retailing, since only small shops and informal traders cater to villagers in rural India. The company found that if it were to invest in building the distribution infrastructure from scratch, it wouldn't be able to sell the stove at a price that its target customers could afford. BP realized that it would have to work with local people who knew rural consumers and had access to distribution agents in the villages. Although the company could hire marketing experts or social workers as consultants, it wanted to develop relationships cheaply with scores of agents so that it could serve a linguistically disparate, culturally diverse, and physically dispersed customer base. While conducting preliminary market research, BP's managers met with three NGOs—Covenant Centre of Development, IDPMS, and Swayam Shikshan Prayog—that operated microcredit operations and other social enterprises in south India.

BP and the NGOs conducted market research together in order to become acquainted with each other's motivations, standards, and capabilities. After that, the two sides defined a shared strategic intent and developed a set of working principles. They built trust through relationships established between key individuals. Trust grew when BP made a long-term contractual commitment to the project. That trust proved to be pivotal, for instance, when the NGOs decided to consolidate distribution channels in five states to generate economies of scale. Most companies prefer to work with several distributors to spread their risks, but BP, understanding the NGOs' pressures, backed the consolidation. The NGOs established a new company that serves as a joint business vehicle through which village agents can pool their investments, licenses, and risk. That was new; the social groups had never before set up a joint operation with one another or with a corporation.

The two sides worked with each other closely at every stage of the project. They refined the business model, developed the rollout plans, and executed them through joint working groups. BP and the NGOs worked together to identify markets and train the distribution agents. They jointly evaluated the stove's design, costs, usability, and safety. They held discussions about the economics of production, distribution, consumer offers (including financing), capital investment, returns, and risks for everyone involved—not only BP and the NGOs but also customers, distributors, and microcredit federations.

BP and the NGOs also tackled the nonnegotiable issues in tandem. BP, for instance, would not compromise on safety standards for the transportation, storage, and use of LPG or violate its own standards of business ethics. Health and safety standards became a central part of the NGO training curriculum; the NGOs' employees even had to learn to use seat belts while driving around. For their part, the NGOs wanted to protect their credibility and goodwill with villagers. BP therefore had to make some accommodations, as well. The company had to ensure, for instance, that the women the NGO's company

recruited as local sales agents were the first to receive cash generated by the business, thus allowing the villagers to recover their working capital.

The manner in which BP and the NGOs struck a commercial agreement bears no resemblance to traditional supplier-channel deals. One difference is the transparency about cost structures and margins. The NGOs, for instance, conducted an analysis of the distribution process, identifying every cost element and breakeven scenario related to LPG cylinders, which are heavier, more regulated, and more dangerous than the products the NGOs usually handle. They conveyed the findings to BP. Suppliers often withhold information from distributors to gain an upper hand during negotiations. In this instance, BP and the NGOs shared their internal economics with each other so they could understand all the choices they faced in terms of distribution costs, consumer service options, growth rates, and breakeven points. This unusual level of transparency helped overcome the traditional mistrust between the two sectors.

The manner in which BP and the NGOs struck a commercial agreement bears no resemblance to traditional supplier-channel deals.

Finally, BP and the NGOs developed a financial model that would allow everyone in the value chain to make money. The NGOs had to assume a great deal of the credit risks and legal liabilities for the agents in the villages. They would not have done so unless they were confident that BP was making a long-term investment in the project. The multinational had to reveal business data it would not normally share with distributors. Drawing up the legal contracts that captured the cocreation-based relationship was a huge learning and confidence-building experience, according to managers on both sides. The process engendered a culture of frankness, transparency, and joint problem solving that is unique in the history of company-NGO relationships.

The benefits of the cocreation approach will have to stand the test of the market, but some advantages are already evident. First, involving credible NGOs that have extensive infrastructure on the ground was tremendously valuable to BP, a foreign company with limited experience in India and no experience with any rural bottom-of-the-pyramid market. Second, the NGOs participated in a complex product-design process and in developing a business model. Doing so benefited them in two ways: They shared in the credit for developing the stove, and they gained credibility as successful collaborators with a global firm. Third, both the company and the NGOs have brought unique balance-sheet advantages to a new business. BP's deep pockets and patience can withstand the trials of a start-up; the NGOs can quickly access other assets, such as land, that the business needs. Finally, BP and the NGOs have together developed a business ecosystem that brings different economic entities—a global corporation, local social organizations, informal micro-entrepreneurs, and a research institute—into an efficient value chain. This alliance offers the promise of more than just access to better products at more affordable prices; it gives people at the bottom of the pyramid, who until now were unable to enjoy the benefits of globalization, a chance to create new livelihoods and gain economic and social influence.

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The same pattern is visible in the cocreation partnerships between ABN AMRO and Accion; Telenor, Danone, and Grameen Bank; Microsoft and Pratham; ICICI Prudential and SEWA; Local Sustainability and CH2M Hill; Microcare and Aon. In all these cases, neither company nor NGO can see the other as an adversary because of their interdependence; both apply assets and competencies to a business that creates greater value for each than their independent efforts could generate. We can judge these partnerships' performance by the level of value they deliver to customers and communities: Companies and NGOs now both share the pressure to perform, cutting through the spin that has too long dominated our understanding of globalization and its opportunities.

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The Three Stages in the Convergence Between the Corporate Sector and the Civil Society

Sidebar **R0702D_A**

Preconvergence

Companies and NGOs adopt different attitudes toward liberalization and globalization. They quarrel over the nature and speed of deregulation. They fight over companies' conduct, especially in developing countries.

Stage One

Companies and NGOs realize they have to coexist. They look for ways to influence each other. Some corporations and NGOs execute joint social responsibility projects.

Stage Two

Some companies get into bottom-of-the-pyramid segments and niche markets even as NGOs set up businesses in those markets. Companies and NGOs try to learn from, and work with, each other.

Stage Three

Companies and NGOs enter into cocreation business relationships. Cocreation entails the development of business models in which companies become a key part of NGOs' capacity to deliver value and vice versa.

The New Rules of Company-NGO Engagement

Sidebar **R0702D_B**

As companies and NGOs work together, they are jointly defining the norms that will govern their future relations and behavior.

- The private and civil society sectors will cocreate markets, along with emerging customers and bottom-of-the-pyramid entrepreneurs, through innovative business models.
- Task-oriented relationships, rather than ideology or policy-driven dialogues, will emerge as the mode of collaboration between companies and NGOs.
- NGOs and companies will need to align global positions and standards and be very local in their ability to serve customers and create value.
- Since both external governance processes and the level of developmental benefits will be internal to the new business models, neither companies nor NGOs can see one another as adversaries.
- Companies and NGOs will gain legitimacy in society by creating bold value propositions that have credible economic, social, and environmental dimensions.
- Companies and NGOs will be under pressure to advocate common policy positions and jointly develop coregulatory schemes.

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