Supply and distribution chains of multinationals: Harnessing their potential for development

By Caroline Ashley

Multi-national enterprises (MNEs) operate in developing countries for many reasons: to take advantage of the availability of specific raw materials, natural resources, labour pools, skills-sets, or processing facilities, or to serve growing customer markets. In many cases, it is their supply chains that matter most in shaping their contribution to enterprise development and local earnings in developing countries. For companies with on-site production, such as mines or hotels, supply chains can be a greater source of local economic impact than the direct payroll. And they certainly outweigh philanthropic investment: Shell’s financial results for 2007 showed that the company spent $17 billion on goods and services from locally-owned companies in low- and medium-income countries, versus ‘only’ $170 million on social investment.

For companies that do not produce or sell in the South, but source their primary inputs there (such as chocolate makers), and for those that contract intermediaries in the South (such as clothing companies), it is the supply chain that delivers impact. For those companies selling households goods in the developing world, from soap to soft drinks, distribution chains may have extensive reach into the local economy surpassing that of supply chains. While providing opportunities for workers, producers and vendors, supply and distribution chains are also where MNEs earn their margins, squeezing returns to low-income supplies or distributors. As such, whatever the sector, the supply and distribution chains of MNEs are major avenues by which MNEs affect the engagement of the poor in globalised markets.

A growing focus on supply and distribution chains

From a business perspective, supply chain management is not primarily about development, but is one of the most basic strategies of business to deliver output efficiently. However, in recent decades, as companies have responded to increased pressure to demonstrate their contribution to society and economic development, supply chains have gained attention as a lever through which businesses can boost their development impact. This is based on recognition that:

1. Reforms within the supply chain are a commercially feasible way to deliver local gains in the areas in which companies work. Local gains can be larger and more durable than benefits from philanthropic social investment.

2. Responding to public and investor concern on social performance cannot be done simply by up-grading performance within a multinational, if most local risks and gains are delivered, in reality, through the supply chain. Action within the supply chain is also needed.

The first of these leads companies to view supply chains as an opportunity for innovation; the second as a priority for reputational risk management. Both
pressures have led to increased business attention on supply chain reform. Development organisations and non-governmental organisations (NGOs) have also increased their focus: sometimes publicising bad labour conditions in international supply chains, and, in other cases, collaborating with new schemes that seek to upgrade conditions for farmers and commodity producers, or developing partnerships with business that aim to link the development of small medium and micro businesses (SMMEs) to the opportunities provided by contracts to MNEs.

Various reforms are possible within supply chains, and the additional benefits they generate can be broadly categorised as:

- **Opportunities for growth of domestic businesses**, particularly SMMEs, when they can expand production and markets by increasing their access to big business supply chains. This can, in turn, support enterprise growth, access to finance, and knock-on effects on private sector development.
- **Improved returns and opportunities for those at the bottom of a supply chain**, such as the producers of food crops, cocoa, coffee, rubber, and other commodities.
- **Improved social, economic and environmental standards** – such as working conditions – for low-paid workers in the firms along the supply chain.

There is a new focus on how distribution chains can also create opportunities for poverty reduction, by offering commercial opportunities for small-scale and informal sector vendors (such as those with hand-carts, village shops) to boost their profits and reach by distributing affordable products of MNEs.

**Different approaches to supply chain benefits**

There are many different ways in which MNEs can adapt their supply chain to optimise development benefits, depending on the type of sector and production model of their operation. Broad categorisations, outlined in Figure 1, are:

1. **MNEs with in-country presence expanding procurement from domestics SMMEs and helping them to develop**, usually as a boost to local economic development;
2. **MNEs that procure mainly via intermediaries**, rolling out minimum standards among sub-contractors, main suppliers and consolidators, to boost working conditions and reduce the incidence of bad social and environmental practice;
3. **MNEs or intermediaries engaging with small-holder farmers and other commodity producers at the bottom of the supply chain**, to develop their productive capacity or create a contracting model with higher returns or lower risks. This ranges from capacity building among farmers, to new blends of insurance, fertiliser and seed provision within contracts, to complying with Fair Trade certification.

Approaches to harnessing distribution chains are in their infancy. The question of benefits that accrue to

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**Figure 1: Different approaches to responsible supply chain management**

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MNE

1. SME sourcing and support e.g. SME linkage devt around a smelter

Domestic producers: procured in-country

Intermediaries: main suppliers, sub-contractors

Small-holder farmers, commodity producers

2. Reform via intermediaries: supplier codes e.g. in textile chain

Strategies used to boost development impacts via supply chains

3. Support to small producers/ farmers: e.g. capacity building, price/ risk stabilisation with farmers innovative input-output contracting, certification standards
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Box 1: Examples and resources explaining the different approaches

Developing linkages with small, medium and micro enterprises (SMMEs)

- Assisting SMMEs to develop and access corporate supply chains has been a major focus of advisory work on SMME linkages by the International Finance Corporation (IFC), working with several international companies, particularly in the extractive sectors. A review of issues and examples is provided in ‘Business Linkages: Lessons, Opportunities and Challenges’ (Jenkins et al., 2007).
- Corporate case studies also appear in other synthesis reports. Harvard University, for example, has a series of Economic Opportunity reports looking at the role of businesses in a range of sectors including extractive, food and beverage, utilities, financial services, and the automotive industry.
- The most comprehensive good practice guide to this approach stems from one of the first linkage projects developed by the International Finance Corporation (IFC), first developed around the Mozal aluminium smelter in Mozambique, and now extended across five MNEs. The guide, ‘Developing SMEs through Business Linkages – The MozLink experience’ provides the step-by-step process of SMME facilitation over a 12-month cycle (Jaspers and Mehta, 2007). Other sources of hands-on guidance have also emerged, including tips for the construction sector (Wells and Hawkins, 2008) and the tourism sector (Ashley et al., 2005) on how to help SMMEs enter the supply chain.
- Some initiatives focus more on working with the small enterprises and their capacity to enter supply chains, such as the Small Business Project (in Tanzania and South Africa) and Technoserve, who develop SMME business capacity around major investments.

Rolling out improved standards and codes among suppliers

- Many consumer-facing industries now have codes of conduct or minimum standards for suppliers. Some are developed individually by the company. For example, in response to criticism of poor working conditions, Levi Strauss developed its own Terms of Engagement for suppliers. Coca-Cola also has a code of business conduct for suppliers. Others standards are developed across an entire sector. For example, the UK outbound tourism industry has adopted the Travelife Sustainability System by which overseas hotels are audited; in the cotton sector, the Better Cotton Initiative’s (BCI) is establishing global principles and criteria for regional implementation.
- Other initiatives cut across sectors, such as the Ethical Trading Initiative (ETI) which ‘tries to ensure that decent minimum labour standards are met in the production of the whole range of a company’s products.’ The ETI Base Code, incorporating conventions of the International Labour Organisation (ILO) on labour standards, is applied not only to direct employees of signatory companies, but throughout their supply chains. Similarly, the Business Social Compliance Initiative (BSCI) aims to improve social compliance (i.e. working conditions) in global supply chains through progressive implementation of the BSCI Code of Conduct (and beyond that, of best practice) within supply chains.
- See Sustainability et al. (2008) for a detailed listing of initiatives, their coverage, and role in supply chain reform.

Work with small-holder farmers and commodity producers

- Adapted business models of purchasing and contracting can provide farmers with reduced risk, greater access to finance and productivity-raising inputs, economies of scale, market intelligence or higher income. This may be done directly by a company, such as Calypso Foods (a specialised fruits and vegetables exporter working with 5,000 farmers in India), in collaboration with NGOs such as Oxfam (working with hotels and farmers associations in the Caribbean) or Care International (working with farmers around a mine in Madagascar), or with a technical institution (such as a university in Indonesia working with Unilever on piloting alternative supply chains for black soybeans).
- Several standards and certification processes relate to farmers: GlobalGAP sets standards for certification of agricultural products. It is a business-to-business standard, required for most exports to European markets. Consumer-facing labels based on certification include, for instance, Fairtrade, Rainforest Alliance, or Utz Kapeh. Schemes vary in their balance between imposing standards and cost of compliance, or assisting producers to improve, and between environmental and socio-economic concerns. Further comparison can be found in an article by Ethical Corporation (2007) and a review questioning their development impact (Ellis and Keane, 2008).
the poor as consumers, via the sale of low-cost goods and services is a different issue that is not covered here, but is well covered in other ‘base of the pyramid’ discussions. The scale and reach of enterprise opportunities generated by distribution chains of consumer goods MNEs was quantified only recently. The fact that Unilever Indonesia’s distribution and retail chain outperformed the supply chain with ease in generating employment (165,000 full-time equivalent jobs, compared to 105,000 in supply) surprised many (Clay, 2005). Initiatives to open up distribution chains to more poor entrepreneurs are only just emerging, but two business models are already apparent:

1. Adapting the distribution model to increase opportunities for large numbers of lower-skilled (hence poorer) participants (as in Coca-Cola’s Manual Distribution Centres in East Africa);

2. Piggy-backing on commercial distribution networks to increase access of the poor to affordable additional services (such as promoting financial services via bakery networks in Mexico).

No categorisation is water tight, categories overlap, and companies may combine with each other over time. The enterprise linkage approaches of SABMiller and Sodexo reach out to local processing and service firms (approach 1), as well as to farmers (approach 3). Cadbury’s work with cocoa farmers in Ghana includes new business models and certification with farmers, combined with work with their purchasing intermediaries, merging approaches 2 and 3.

Approach 3 identifies the critical role of new agribusiness models, whether for MNEs developing new procurement practice, or for intermediaries utilising contracting models that enable small-holder suppliers to adopt sustainable production practices. Disaggregation and analysis of such approaches is being carried out by Monitor Group, distinguishing ‘contract production’ models in which contractors provide critical inputs to suppliers, from ‘deep procurement’, in which purchasers by-pass intermediaries to source from networks of farmers (Karamchandani et al., 2009) and by Oxfam, which is reviewing innovation in producer-driven, intermediary-driven and retailer-brand driven agricultural supply chains (Oxfam, forthcoming).

There are diverse examples of each approach to supply chains, several of them highlighted in Box 1. The appropriate model varies enormously by sector, with some fairly obvious correlations: SMME linkages are developed in the extractive sector (such as oil and gas), supplier standards in the clothing industry, Fair Trade certification in coffee and chocolate, and a variety of small-holder support schemes cut across food and agricultural sectors. There is now a substantial body of ‘good practice guidance’ on developing SMME linkages (approach 1) from the extractive sector, though this is not necessarily well accessed by other sectors. There are multiple schemes for ensuring good practice standards among suppliers, (approach 2). However, the development impact of standards is debated. Some simply raise the bar for developing country producers, letting small producers, not MNEs, bear the costs of more ethical production (Ellis and Keane 2008). Where producers are supported to enhance standards, development impact is more likely to be positive. Engagement with farmers and commodity producers (approach 3) is already an area in flux, and will become more so in response to (1) higher food prices; (2) uncertainty over sustainability of some agricultural supplies, particularly as climate change effects intensify; and (3) the evolving consumer agenda over ‘food miles’ and other aspects of supermarket supply chains.

Building on experience, asking questions of the future

The business case

Risk minimisation has been a strong and long-standing business case, particularly for action to raise standards among suppliers. But current reality is considerably more complex and requires more than risk minimisation. In the extractive sector, mines invest in mentoring and contracting SMMEs, partly to reduce operational risk via a stronger social licence, but also to gain competitive advantage over other bidders by demonstrating their value to governments (see Sodexo example, Box 2). In the food sector, securing the sustainability and quality of supply is a key driver: Cadbury’s investment in Ghana is not just because cocoa farmers are poor and deserving, but because Ghana’s cocoa is of the highest standard and, at the same time, faces threats to sustainable production. Localising supply chains may involve high transaction costs in terms of disruption at first, but, over time, it can deliver more flexible, resilient and low-cost suppliers. In retail sectors, expanding access to more remote markets cost-effectively is a business driver for helping village entrepreneurs to enter the distribution chain, as experienced by Unilever in Indonesia, and Coca-Cola in East Africa.

One of the lessons for companies from experience to date is that a company needs to thoroughly assess, understand, and deliver, its business case. An example from the Body Shop (Box 2) shows just how subtle the different business cases can be, and how the firm needs to fine-tune in order to deliver them.

However, positive business returns should not just
be assumed. A recent report by SAB Miller is refreshing in revealing variation in the business benefits – as well as the socio-economic impacts – of their supply chain programme. As the graph in Figure 2 shows, there are countries where both commercial and social benefits are high (e.g. India), both are low (e.g. South Africa), and where business benefits are high relative to socio-economic ones (Zambia) (SABMiller, 2009, pp 11). While we can be confident that business drivers for supply chain reform are strong in some circumstances across a range of MNEs, there are, no doubt, other cases where the business case may be too weak, too long-term compared to short-term implementation costs, insufficiently understood, or simply outweighed by the drive to boost margins.

The global economic crisis creates business incentives in the opposite direction: to push cost-cutting pressures down through supply chains, and to switch away from higher-cost, higher-standard suppliers to low-cost producers. There are also indications that the appetite of MNEs to invest in new programmes, such as linkages with SMMEs, is lower, although the picture is diverse. For low-income producers in supply chains, avoiding further squeeze on margins is a priority.

Internal change

Another lesson from experience is that implementing supply chain reform takes detailed and painstaking change management of internal systems and procedures. This may be a major obstacle to the scale of

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**Box 2: The business case varies**

**Competitive advantage:** Universal Sodexo (a global food and facilities maintenance company) recently secured a substantial facilities maintenance contract with a RioTinto iron ore mine in Australia. The bid included an innovative approach to supporting aboriginal people to develop indigenous enterprise. This went beyond just preferential procurement in the supply chain, to include investment in a three year incubation period to assist indigenous enterprises before they become regular suppliers. This was a major source of competitive differentiation and helped secure the bid.

**Consumer appeal:** For the Body Shop, the business case for Community Trade is multi-layered and evolving. It began as a personal commitment by the Founder, and has become a distinctive brand characteristic. But the brand value cannot be simplified. The ethical nature of the brand helps bring customers into the shop. But once there, at the point of selecting and buying a Body Shop product, the drivers of consumer behaviour switch from ethics to reliability, performance and quality. At the level of the product, Community Trade has a slightly different benefit, enabling The Body Shop to guarantee traceability of supply – hence quality – plus inputs of indigenous expertise. So Body Shop’s engagement with communities is conveyed to consumers in different ways at different points in the customer’s store experience, delivering different consumer and business benefits.

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**Figure 2: High level overview of small-holder programme performance**

- **Zambia:** 2,600 farmers (steady state). Sourcing from commercial farms reduced positive socio-economic impacts.
- **India:** 6,024 farmers – rapid growth in market. Small-holder sourcing central to expansion plans.
- **Uganda:** est. 5,800 farmers (steady state i.e. levelling peaks and troughs).
- **Tanzania:** 686 farmers – limited business benefits over commercial sourcing.
- **South Africa:** 158 farmers – reducing numbers over years due to irrigation challenges.

Source: Adapted from SAB Miller (2009).
uptake. But because it involves internal systems, it is discussed little in the public domain. One example made public comes from Spier Hotel in South Africa (Ashley and Haysom 2009), where the champion and facilitator of supply chain reform worked both to support SMMEs and to manage internal change. Overcoming resistance on the part of the Buyer, and building staff understanding of the principles of supply chain reform, were critical. Quick wins, tackling problems before they could derail suppliers, and changing staff Key Performance Indicators (KPIs) were all important. Such effort was required in a 200-employee business. Consider then the technical effort required for a major energy company to adapt procurement to support SMME participation: amending tenders, pre-tender qualifications, contracts, KPIs, and reporting formats at numerous levels of the firm, from project site to country office to HQ. Level of corporate effort has to be one of the factors determining where in the supply chain to seek change. Figure 3 shows how Exxon Mobil analyses the trade-off between effort and the potential for impact on local employment.

If initial transaction costs of change are so high, can companies be sure that supply chain reform is worth the effort, or can incentives help overcome this barrier? The value of soft funds, the need for an internal champion, and importance of revising staff KPIs are lessons captured repeatedly in reviews of corporate experience of adapting business models. Beyond these, experience of how to assess or manage internal costs is scarce.

Intermediaries

Intermediaries (suppliers, sub-contractors, consolidators) play a massive but challenging role in supply chains. On the one hand, this can make change harder to achieve for MNEs that rely on intermediaries. It is harder to improve employment standards if you cannot control them directly. On the other hand, much innovation is being driven by southern companies, developing new business models in their links with small-holders and small enterprises. Forthcoming Oxfam work highlights domestic firms as a strong source of innovation in business models that benefit small-holders. While these firms may, in turn, supply to MNEs, the innovation is not driven by buyers, and may in some cases conflict with top-down imposition of certification standards. MNEs perhaps face a choice between investing in fixed standards, with all the implementation costs involved, or seeking out more fluid and innovative models, with the risk of ad hoc delivery.
Development gains – sustainability and scale

The development gains to local producers and distributors seem to be significant, but are often anecdotal. Pilot initiatives start small – of necessity – but there are several examples in which beneficiaries are in the thousands, or additional contract revenue reaches the millions. For example: when M&S became the first major UK retailer to sell products made from Fairtrade cotton, it was estimated to be improving the livelihoods of more than 1,500 Indian farmers (Shell Foundation 2009). By 2018, Cadbury estimates it will have made a demonstrable difference to the lives of around half a million Ghanaian farmers (Cadbury 2009). Contracts won by SMMEs within IFC-supported linkage programmes run into the millions of dollars per year. In East Africa, around 1,800 Manual Distribution Centres set up by Coca-Cola have created direct employment for around 7,500 people so far (Coca-Cola 2009).

But hard data are relatively rare and ad hoc. Few examples put these benefits in perspective, relative to the size of the company, the total supply chain, or the effort and investment made in creating change. Costs to those displaced from prior contracts are rarely mentioned, although evidence exists that the costs of complying with standards can be simply too high for poor producers, who may thus become excluded from the market (as happened with GlobalGap (Ellis and Keane, 2008)). We do not yet have the tools to assess which approaches offer greatest return for effort, or to help companies choose which approach to use in their circumstances. Most successes seem to be generated through collaboration, involving corporate action, public investment and/or NGO-type facilitation, so scale-up will also depend on the evolution of effective consortia.

A parallel approach of donors seeking development impacts at scale is Marking Markets Work for the Poor (M4P). This also seeks to unleash local enterprise, but by adapting market systems to create business solutions (such as in finance and insurance) rather than focusing specifically on the supply chain of a corporate or value chain of one sector. Anecdotal evidence suggests these two approaches can be mutually reinforcing. In a Caribbean project, Oxfam found that action by large hotels to source from farmers was complemented by agricultural market reforms to remove barriers to farmers, ranging from affordable production finance, and smallholder business development, right up to national and regional trade policy distortions (Oxfam, forthcoming). In other cases, the fact that corporates adopt business solutions to upgrade their small suppliers can be a good example of an M4P approach (i.e. driven by business not subsidies) to problems of low-quality local suppliers. However, analysis of the complementarity of the two approaches is lacking.

Moving ahead

The substantial scale of MNE supply chains in poor economies is clear, and several case studies illustrate adapted business models that work commercially and developmentally. But four big issues need further exploration:

1. Are companies and development organisations missing out on the potential to harness supply and distribution chains for development impact? If so, why, and what should they do in future?

2. The primary reason for development interest in supply chain reform is that it can – in time – deliver impacts at greater scale: the financial flows can be large and so can the sustainable spin-off impacts on enterprise growth. But are impacts at scale being achieved? Are companies actually moving on from successful pilots to further replication? What are the critical success factors that enable replication and uptake at scale? Is there a role for donors to support this, whether with soft grants, M4P approaches, innovation support, or in other ways? Do we need more work to understand how the poor benefit: who and how much?

3. There appear to be many examples of commercial-social win-wins. But if that is true, why are there not more and bigger examples of companies adapting their supply chains to benefit poor producers? Is it just a matter of time, or do we need to reassess the apparent win-wins? A more detailed examination is needed to assess when the business case overlaps or conflicts with development gain, and how companies deal with any conflict.

4. How is the global economic crisis affecting the interest and potential for companies to harness their supply chains for development gain? Will opportunities to innovate with poor producers and entrepreneurs be outweighed by pressures to slash costs? At times of contraction the value to developing countries of global supply chains is thrown into sharper relief. For the increasing numbers of unemployed workers in developing countries, the question of whether supply and distribution chains can be harnessed most effectively for their economic development is critical.

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References and additional resources

Key references:


Additional resources:
Better Cotton Initiative: http://tinyurl.com/d5zq3o

Business Social Compliance Initiative: http://tinyurl.com/c77tv

Cadbury’s cocoa partnership: http://tinyurl.com/djluv

Calypso Foods, farmer partners: http://tinyurl.com/dlkcv

Coca-Cola code of business conduct for suppliers: http://tinyurl.com/dmfxs


Ethical Corporation article for Responsible Business Summit 2009: http://tinyurl.com/c8t7k7d

Ethical Trading Initiative Base Code: http://tinyurl.com/d73v5v

EurepGAP: http://tinyurl.com/cmg923

Fairtrade Foundation: http://www.fairtrade.org.uk/

Levi Strauss code of conduct: http://tinyurl.com/cqm8c9

Rainforest Alliance: http://www.rainforest-alliance.org/

Ethical Corporation article for Responsible Business Summit 2009: http://tinyurl.com/cbhti


Sodexo Madagascar, our corporate responsibility in 2007: http://tinyurl.com/d47vz0n

Technoserve: http://www.technoserve.org/

Travelife Sustainability System: http://tinyurl.com/dkv7d


Utz Kapeh: http://www.utzcertified.org/