Innovating for environment and society: an overview

Policy pointers

- **Business models for** sustainable development aim to deliver economic, social and environmental benefits – the three pillars of sustainable development – through core business activities.
- **The value proposition** (tangible results from goods or services) in these models includes social, environmental and economic values, while value distribution within the market chain is a key feature.
- **Businesses need to build** their own capacities and strategic alliances with other enterprises, government agencies and development practitioners.
- **Involving local communities** as partners and co-designers of new models enhances local buy-in and ownership.
- **Significant investment of** time and resources at the start is key for building strong working partnerships, and successful innovation, experimentation and scale-up, but models need to be self-sustaining in the long term.
- **Trade-offs among different** sustainable development goals need to be recognised and addressed.
- **Ongoing monitoring and** evaluation needs to be built in to the business model.

Can business deliver on sustainable development goals? Market-based activities are now recognised by governments, business and development agencies round the world as potential solutions to major sustainable development challenges – reducing poverty, enhancing livelihoods, protecting ecosystems, tackling climate change, and meeting the Millennium Development Goals. Increasingly, the private sector is recognising an emerging business opportunity in designing or modifying business models specifically to address such issues. This evolution has been patchy and ad hoc, however, and many innovative pilot initiatives have succeeded at the micro level but failed to achieve success at scale. Businesses must build their own capacities to work effectively for sustainable development, and engage in strategic alliances with other enterprises, financial service providers, government agencies, development practitioners and communities.

Business for people and planet

Electricity, drinking water and healthcare are just some of the essential services now increasingly delivered by the private sector in low- and middle-income countries. This sector – including small- and medium-sized enterprises (SMEs) and informal businesses – also provides some 90 per cent of jobs in developing countries and emerging economies.

This sector clearly has massive potential to play a key role in sustainable development – a realisation rapidly growing among agencies and NGOs in the field. More recently, the private sector itself has paralleled this shift in awareness. Major companies and SMEs alike are beginning to realise their own potential as partners in sustainable development, and how important that is in mitigating risk and enhancing business and investment opportunities.

Direct business incentives for this kind of involvement include certification in the forestry and agrifood sectors, government requirements for creation of local employment and business opportunities in the oil and gas industry, and international environmental management standards.

Through these, companies are encouraged to build sustainable development goals into their business models – that is, the ways they organise themselves and their relationships to create and capture value (through production and marketing).

In lower-income countries, businesses are designing and modifying such models to respond to specific sustainable development challenges. These include the delivery of affordable goods and services to poor communities; opening access for small suppliers to new, more stable markets offering greater net benefits; supporting local capacity to produce environmentally sound goods and services; and responding to the demands of climate change mitigation and adaptation, as well as other urgent environmental considerations.

Businesses are looking to align their support for local enterprise more closely with their core business activities, moving beyond donor-subsidised interventions and the philanthropic activities that have characterised traditional corporate social responsibility (CSR) to date.

This briefing, the first in a new IIED series, profiles the concept of business models for sustainable development. It explores some of the challenges associated with designing and implementing them. There is, for instance, the need to address trade-offs among poverty reduction and environmental preservation, while promoting more equitable distribution of costs, benefits and opportunities.

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The briefings and opinion papers to come in this series will explore specific sectors and case studies in greater detail.

Basics of a business model

At the centre of any business model is the company's 'value proposition' – the products and services that yield tangible results for the company's target customers. A company's value proposition is what makes it different from its competitors.

In creating business models for sustainable development, the two broad areas for possible adaptation and innovation are production and marketing. The production side comprises the set of activities, mechanisms and relationships for providing a good or service – in other words, creating value. The marketing side comprises the activities, mechanisms and relationships for selling that good or service – in other words, capturing value.

Sustainability from the inside out

Business models drive a company's core business activities and influence the management of contractors and suppliers. So by integrating sustainable development goals into business model design, a company is more likely to successfully deliver sustainable development outcomes.

In traditional CSR approaches, efforts to address local environmental and social issues are relegated to the margins of company activity, and support for such projects is frequently short-term and ad hoc. These efforts may be a response to local political agendas, and frequently remain unrelated to the core activities of the company – and as such are not seen as integral to the business. Companies whose CSR approaches merely amount to 'peripheral philanthropy' may also end up withdrawing their support in times of economic uncertainty.

The key design principles

Given the diversity in business, there is no 'one size fits all' solution to designing or adapting business models to address sustainable development challenges: they have to be tailored to fit. However, some key principles are emerging.

First, value is more than financial capital. It also encompasses trust and other forms of social capital, along with natural capital – environmental goods and services. Securing a balance in all these forms of capital can enhances the resilience and flexibility of businesses and supply chains.

For example, a forest enterprise can enhance its long-term financial prospects by ensuring that forest resources are harvested sustainably and by avoiding conflict through support for community forest enterprises and traditional livelihood activities. ***So the 'value proposition' of a business model for sustainable development needs to be considered in terms of financial, environmental and social value.***

Secondly, to deliver sustainable development benefits through core business activities rather than philanthropy, ***the company needs to look not only at value creation and capture for itself and its customers, but also value distribution throughout the market chain.*** This chain may include small-scale producers, local small-scale and social enterprises, and service providers such as banks. Creating value for partners in the chain helps to develop more robust, efficient and resilient market chains that benefit all participants.

Issues of ownership, market access and equity (that is, who benefits from business activities) need to be considered alongside profit margins and delivery of value to customers. The model needs to ensure that financial, environmental and social values are distributed equitably and not offset by unforeseen negative impacts for particular suppliers, customers or other partners.

The more effective and long-term business models for sustainable development are designed and implemented via collaboration. This might take a range of forms: collaboration with government and enterprise associations on local skills training programmes in the oil and gas industry (Wilson and Lynch);* training for local community members and enterprises in maintenance of solar home systems (Wilson *et al.*); or creating opportunities for local producers to take part in agrifood supply chains (Vorley).

This kind of collaboration has direct benefits for business as well as development. It leads to greater local buy-in to the business initiative and enables the pooling of diverse skills that can contribute to the success of the business and a positive sustainable development impact. Business planning will require consultation on long-term development needs and available capacities.

The need for adaptation and new alliances

Depending on the social and environmental opportunities and problems that a firm faces, an existing business model may require a mere tweak or a major shake-up. Innovations that offer greater productive or technical efficiency are an obvious and popular adaptation as they offer 'win-win' outcomes through reduced total costs and enhanced benefits.[1] On the marketing side, a new business model might involve packaging a product for a particular market.[2]

This discussion, however, focuses less on technical adaptation and more on organisational adaptation,

**All parenthetical references are to upcoming briefings and opinion papers in this series, listed on page 4.*

collaboration and capacity building. In the agrifood sector and wildlife products trade, for example, sourcing from many small-scale producers raises issues of product integrity, safety and quality in a very broad supply base. This requires innovative approaches to traceability and use of intermediaries (Vorley and MacGregor). Specialised procurement hubs (supplier co-ordination centres) in the agrifood sector enable sourcing from a large number of disparate small-scale suppliers (Vorley).

Some business models for sustainable development aim to provide an affordable and flexible service for a previously unserved set of clients and customers. This demands new types of partnership with government, donors, development practitioners and/or communities (Lynch *et al.* and Wilson *et al.*)

The involvement of communities is often key, not only as consumers and producers or subcontractors, but also as partners in development (Macqueen, Vermeulen *et al.* and Wilson *et al.*) This may extend to co-design of the business model. Building business alliances with local communities is particularly challenging and demands the right development expertise.

New types of alliance among supply chain participants have emerged. In agrifood, alliance-based business models are integrated partnerships of several enterprises in a supply chain competing with other similarly integrated partnerships, often across international borders (Vorley). Producer associations can create more economic value for their members by sharing the costs of certification or processing technology in forestry and agriculture (Macqueen and Vorley). Collaboration enables co-investment by partners, through financing but also, crucially, through information-sharing. This is particularly important in developing countries where the informal sector dominates trade, and investment is hampered by poor information flows.

Business models for sustainable development are likely to require the involvement of intermediaries, which could be entrepreneurs, private companies, producer associations, or social enterprises, and may have skills related to both business and development (Vorley, Macqueen, Wilson *et al.*, and MacGregor). Intermediaries may link many small-scale suppliers with a manufacturer or retailer, provide development expertise, or provide information about changes, risks or new technologies. It is important that long-term intermediary roles become financially self-sustaining and do not depend on regular donor support.

Further strategic inputs may include financial or business development services, knowledge development and dissemination, policy support or external facilitation to start up or scale up a pilot initiative. Such inputs are frequently provided through partnership with the government or development practitioners, but the business model should not be dependent on such support over the long term.

Challenges facing new business models

These new value propositions are proving worthwhile for the early adopters and are driving innovation. But there will always be trade-offs among different elements of sustainable development. It is important to ensure that social and environmental considerations are given as much thought as the financial imperatives of business. In demanding economic times, this is particularly important, as motivation in the private sector is more likely to favour financial returns over other less tangible benefits.

For instance, in cases where a business-based approach is used to address poverty, the selection of a target consumer community is likely to be driven primarily by the community's ability to pay for the proposed service or product, rather than on meeting the needs of the poorest and most vulnerable. As a result, 'the poor' will be targeted rather than 'the poorest' (Wilson *et al.* and Lynch *et al.*) A common trade-off is between socio-economic development through preferential procurement ('local content') on one hand and environmental and social performance goals on the other (Wilson and Lynch).

While there are many cases of successful pilot initiatives, a bottleneck to long-term sustainability is how to scale up and replicate initiatives. In some cases, partners in the business model can finance scaling up and attract further investors. In other cases, supplementary donor finance or government subsidies may help to stimulate replication and adaptation. However, in the longer term, business models need to be self-sustaining. Scaling up is acknowledged to be an area that needs particular attention and support, and will demand close documentation.

Local buy-in and capacity are critical if the venture is to contribute effectively to sustainable local development. Local communities and governments need to have the skills to play a long-term role in management and implementation. Time, effort and money are needed to build capacity in local producers, suppliers and consumers to contribute effectively to and benefit from the new opportunities. Affordable financial arrangements such as micro-credit may be required for local enterprises. The ability of local communities to pay for goods and services is also crucial; this may require customer credit arrangements and awareness-raising campaigns.

A supportive regulatory environment is an initial condition for business interest and involvement. Without support from central and local government, there are unlikely to be sufficient incentives to pilot, let alone scale up, successful private sector initiatives and partnerships.

Regulatory support might be the allocation of commercial forest rights to community enterprises (Macqueen); a waiver of land title requirements for urban water supply connections (Lynch *et al.*); or establishing community rights over natural resources round rivers and streams (MacGregor). An ongoing challenge for governments is getting the mix of regulation and incentives right. This also presents challenges to donor agencies eager to replicate and scale up successful pilots.

Impact assessment and ongoing monitoring and evaluation are vital, but tough to put into practice. It is difficult to isolate the impact of business model adaptation on sustainable development outcomes. Effective measurement and attribution will speed up replication and scaling up, and further business model adaptation. More in-depth and systematic documentation and analysis of case studies would help developers and enterprises understand past successes and failures of such models and to invest further effort and financial support in a more effective way.

Businesses that design and adapt their business models to deliver greater broad-based sustainable development impacts can mitigate business risks and enhance investment opportunities, while promoting security and stability of the overall investment climate. The models detailed in this series offer local communities, enterprises and governments the opportunity to participate not merely as development beneficiaries, but as partners in business innovation.

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Other titles in this series

■ Lynch, M. *et al. Channels for Change: Private water and the urban poor* ■ MacGregor, J. *Crocodile Harvesting: An industry that snapped back* ■ Macqueen, D. *Roots of Success: Cultivating viable community forestry* ■ Vermeulen, S. *et al. Biofuels in Africa: Growing small-scale opportunities* ■ Vorley, B. *Link in the Chain: Small growers in today's agrifood markets* ■ Wilson, E. *et al. Power to the Poor: Sustainable energy at the base of the pyramid* ■ Wilson, E. and Lynch, M. *Shared Value in the Oil and Gas Industry.*

Further reading & websites

Ashley, C. 2009. *Harnessing Core Business for Development Impact.* Background Note. Overseas Development Institute, London. See www.odi.org.uk/resources/odi-publications/background-notes/2009/harness-core-business-development-private-sector.pdf. ■ Barsky, J. 2004. *UNDP and the Private Sector: Building partnerships for development.* UNDP, New York. ■ DFID. 2005. *Working With the Private Sector to Eliminate Poverty.* DfID, London. ■ Magretta, J. 2002. Why business models matter. *Harvard Business Review* 80(5): 86-92. ■ Osterwalder, A. 2008. *The Business Model Canvas.* See http://business-model-design.blogspot.com/. ■ Shafer, S., Smith, J. and Linder, J. 2005. The power of business models. *Business Horizons* 48: 199-207. ■ Wilson, E. *et al.* 2008. Lights on or trade off: can base of the pyramid approaches deliver solutions to energy poverty? In Kandachar, P. and Halme, M. (eds) *Sustainability Challenges and Solutions at the Base of the Pyramid,* Greenleaf Publishing Ltd, Sheffield.

Websites of initiatives supporting the role of business in development

Donor Committee on Enterprise Development: www.enterprise-development.org/ ■ International Finance Corporation, International Business Leaders Forum and Harvard University work on Business Linkages: www.iblf.org/resources/general.jsp?id=123929 ■ Philips' 'Philanthropy by Design': www.design.philips.com/about/design/aboutus/sustainablefuture/index.page ■ UNDP's Growing Inclusive Markets: www.growinginclusivemarkets.org ■ UNEP/Wuppertal Institute's Human Development through the Market: www.scp-centre.org/projects/ongoing-projects/human-development-through-the-market.html ■ USAID's Microenterprise Learning Information and Knowledge Sharing (MicroLINKS) platform: www.microlinks.org/ev_en.php ■ World Business Council for Sustainable Development/Netherlands Development Organization (WBCSD/SNV) Inclusive Business: www.inclusivebusiness.org

Notes

■ [1] Weizsäcker, E., Lovins, A. and Lovins, L. 1997. *Factor Four: Doubling wealth – halving resource use.* Earthscan, London.
■ [2] Prahalad, C. and Hart, S. 2002. The fortune at the bottom of the pyramid. *Strategy and Business* 26:1-15.

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