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Sourcing Locally for Impact By Ethan B. Kapstein & René Kim

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By
mapping a company's
relationship to the economy in
which it operates—and by leveraging the
relationships it discovers in that process—businesses can do
much to advance their strategic objectives and advance local economic growth.

In 2000, Ian Mackintosh, technical director of Nile Breweries in Uganda, a subsidiary of the global brewer SABMiller plc, faced a problem. Sales of the company's clear beers had stalled, and given the relatively high prices for its products, the brewery was having a hard time reaching out to new consumers, most of whom were in the lower income brackets.

But Mackintosh knew that the demand for a cheaper beer existed. Low-income consumers in Uganda weren't forgoing beer consumption; instead, they were drinking home brews, with potentially severe health consequences. Home brews are widely used in many African nations, despite the fact that they can cause serious ailments and even death.

Mackintosh realized that Nile Breweries had to reduce the price of its beer if it were to reach these consumers and offer them a better, safer product. The brewery faced major constraints, however, because many of its costs were determined exogenously, including the price of its imported inputs, chiefly barley, and because of the high excise taxes that the Ugandan government imposed on beer, which the Ministry of Finance, Planning, and Economic Development considered a luxury good. But if Nile Breweries could

substitute for imported barley with a local crop, it could dramatically lower its costs and then, because of its choice to source locally, be in a position to make a reasonable case to government officials for a reduction in the excise tax.

Working with Ugandan farmers, Mackintosh—a South African by birth with extensive experience in the beer industry—discovered that domestic sorghum could serve as a reliable substitute for imported barley. At first, Uganda's family farmers were skeptical about his promise to buy their crop. But once Nile Breweries bought their sorghum harvest, Mackintosh recalled, skepticism turned to enthusiasm, because the arrangement offered good prices and stable demand. And once Nile Breweries was buying produce from thousands of local farmers, Mackintosh found himself in a position to make a compelling case to the government—with the farmers' support—for a lower excise tax on the new beer.

As a consequence, Eagle Lager was born. Today it is Nile Breweries' largest selling brand. But Eagle Lager's success does not rest solely on its low-income customers. To the surprise of Nile Breweries' managers, it has also become a hit among high-income consumers, who have discovered that its taste marries well with the local barbecue.

The case of Eagle Lager exemplifies how a company can leverage its relationships with local suppliers and, in turn, with the government, to build the foundation for a successful product. In this case, Ugandan farmers provided not just inputs to the brewery, but also political support for Nile Breweries' quest for lower excise taxes. Indeed, the farmers were the hinge on which the corporate strategy of introducing a lower-priced brand turned, and they ended up benefiting greatly from a steady market for their sorghum.

Hope Ruhindi Mwesigye, Uganda's former minister of agriculture, said of the arrangement: "We have all gained from Nile Breweries' commitment to working with us to develop value-added agriculture through local sourcing from thousands of Ugandan farmers. I encourage other leading global companies to see this as a model for how to partner locally to advance economic growth."

Still, Eagle Lager has not become a well-known business model. Most managers have a long way to go when it comes to leveraging their local relationships and using them to support corporate strategy. Currently managers—especially those at corporate headquarters—tout the benefits of global sourcing because they believe it's a cheaper method of acquiring needed inputs; and they don't think deeply about the long-term benefits of establishing relationships with local stakeholders. In fact, in our experience, managers view their interactions with domestic stakeholders primarily through the lens of corporate social responsibility or public affairs rather than as a core element of their company's strategy.

In this article we argue that a careful, quantitative analysis of stakeholder relationships can provide a useful complement to the strategy-building exercise happening at most multinational corporations. Drawing from the experience of different companies in banking, mining, and fast-moving consumer goods, and operating in countries across the industrial and developing worlds, we show how a deep knowledge of local markets has opened up new business opportunities.

Leveraging corporate relationships, however, requires that managers reconsider how they acquire the goods and services that their firms need. In particular, they must ask themselves whether cost alone is the appropriate metric for making their sourcing decisions. We argue that rather than focus narrowly on cost, managers would do better from a competitive standpoint if they considered the social and economic impacts of their decisions. In short, they should contemplate the following hypothesis: *The greater the impact of a firm's sourcing decisions on local economies, the more constituents the firm will develop in support of its strategic goals.*

WHY SOURCE LOCALLY?

Since at least the 1980s, multinational corporations have turned increasingly to global sourcing as an approach to supply chain management. Business analysts often see this trend as the result of two forces: an internal force that is coming from shareholders and the board for companies to focus on core competencies or

be penalized by the stock market; and an external force that stems from the widespread belief that globalization of any and all parts of the production process will lead to higher profits. Taken together, these trends have driven managers to seek suppliers globally who have a cost advantage in providing goods, services, and labor. Because external suppliers of goods and services can account for a large fraction of a company's expenditures—significantly more, for example, than direct employment—reducing that outlay can be crucial to a company's competitive advantage and cash flow.

This tendency toward global sourcing is premised on the assumption that needed inputs can be provided at lower cost and with greater reliability, because firms with multiple suppliers won't face holdups from their dependence on a single local supplier or capricious government regulation. In many cases, global sourcing also can lead to higher quality products. Global sourcing allows companies to adopt just-in-time production more readily as supplier relationships become transactional rather than based on long-term commitments. This, in turn, reduces the need to maintain inventories and tie up costly capital. Stephen Rogers and Lisa Cooley, two executives from Procter & Gamble Co., argued in a 2004 International Supply Chain Management Conference paper that global sourcing "sounds like a no-brainer."¹

But the Procter & Gamble executives quickly note that it's "not that simple." Problems can include rapid changes in exchange rates, which make foreign suppliers less competitive than they were yesterday; higher monitoring costs, especially when suppliers speak a language different from employees at corporate headquarters; different legal systems; and political risk. Simply put, although the benefits of global sourcing may be easy to quantify, the costs and risks are often harder to calculate and, as a result, they may be overlooked or understated by corporate decision makers.

Some scholars have sought to devise simulation models of global vs. local sourcing as a proxy for such measurements. In one particularly innovative study, Woo-Tsong Lin of the Department of Management Information Systems at National Chengchi University in Taipei, Taiwan, and his colleagues conducted simulations of several different approaches to corporate supply chains, based on different types of enterprises, goods, and services. They found that global sourcing is hardly a no-brainer, and that the reliability of global supply chains varies greatly across the goods and services provided.²

Our objective, however, is not to rehash these now familiar debates about global vs. local supply chains. Instead, we wish to dig deeper into sourcing decisions by examining the strategic role of local stakeholders, including not just suppliers but also consumers, governments, and representatives of civil society. These stakeholders should not simply be conceptualized as generators of goodwill or public relations for a firm in the places where it operates, but as key players in determining the success or failure of the company's market entry and market development decisions—and even of its continuing ability to secure a license to operate.

We have observed through our consulting work for leading multinational corporations that very few headquarters managers pay sufficient attention to the externalities, both positive and negative, associated with local sourcing decisions. To give just one example, we were working at the African subsidiary of a multinational corporation

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that, due to a decision made in its distant headquarters, stopped using a very competent local training company. Headquarters wanted consistency in all its training programs and signed a global contract with a large international consultancy. What the managers at headquarters failed to recognize was that the local firm had deep ties to its community and to the government, and that it was helpful to the firm in ways that went far beyond the provision of staff training. By outsourcing the training, the company reduced the number of locals it was employing and turned to expatriate expertise. The possible consequences of this type of decision in bad publicity are rarely computed at headquarters. Conversely, the possible benefits or externalities of going local are seldom analyzed.

The problem is not just one of measurement—although that’s crucial and we will discuss it in greater detail below—but also one of incentives. Managers usually are rewarded for short-term improvements to a company’s competitive position, as reflected, say, in its stock price. This makes transactions based on directly observable costs a tempting proposition; if a widget from a global supplier costs less to buy than a widget from a local supplier, then why not acquire it overseas? Managers have little incentive to map out all the positive externalities that local purchases may create.

But what if managers had a method for assessing the social, political, and economic impact of their business decisions? What if they could chart or map all the ripple effects of how they produce and sell goods and services? If they had such a tool, they might see the broader consequences of their sourcing decisions. That, in turn, might lead them to re-examine the costs and benefits of global vs. local sourcing, and to see these calculations in a different light. Let’s consider a few cases where managers have done just that.

MAPPING RELATIONSHIPS

We believe there are several reasons managers should map out their local relationships, including discovering market development opportunities and fostering political and civil society support for corporate strategy, as Nile Breweries found when it developed Eagle Lager. By examining relationships with workers, suppliers, nongovernmental organizations, and public agencies, managers become anthropologists, developing local knowledge that can provide insights into consumer behavior and a network of constituents who can support a company’s objectives. After all, domestic actors are likely to have more influence within their communities than any multinational enterprise can muster on its own. Without broad community support, firms may even struggle to sustain their licenses to operate.

Mining companies often find themselves in that category, with local stakeholders opposing licenses to operate on the grounds that mining leaves communities worse off environmentally and economically. Indeed, mining creates so much strife that some governments choose to nationalize the industry, as happened recently in Bolivia and Ecuador. In May 2010, the Australian Parliament passed a “super tax” on all mining operations, which was transformed into a lower “resources rent tax” on only iron ore and coal after considerable industry opposition.

Most mining companies do little to improve their local

relationships, often turning their backs on local communities and operating as enclaves removed from public scrutiny. By thinking strategically about their real or potential relationships with the communities and countries in which they operate, however, they can avoid these pitfalls and be viewed as valued partners in economic growth and development goals.

To provide one example of strategic thinking about local relationships, Newmont Mining Corp., the world’s largest gold producer, in cooperation with the International Finance Corp., developed a comprehensive “linkages” program with suppliers based in the Ahafo region of Ghana beginning in 2006. This program focuses on developing local entrepreneurs who can provide goods and services not just to the mine but to the district that surrounds it as well. Within the last five years, the company has supported the development of local construction and catering companies, which are engaged in a variety of governmental and nongovernmental projects. Newmont Mining also has created a foundation with revenues from the mine that serves as a funding agency for local projects; the board of directors is drawn from the Ahafo region, which reviews proposals submitted by community organizations. As a result, Newmont Mining has won public support in the community for its operations. That support is vital as Newmont Mining counters perceptions that it is taking Ghanaian gold without providing much benefit to the nation and its people. (See “Newmont’s Impact on Jobs in Ghana, 2009” on p. 52.)

Another example of local stakeholder building, also from Ghana, is the Standard Chartered Bank, which has operated in that country for more than 100 years. Despite this long-standing relationship, many in Ghana view Standard Chartered as a foreign enclave that finances only global corporations and big projects, such as the country’s new offshore oil fields. It has come under attack from the business press and representatives of civil society for not being more active in promoting the local economy.

A detailed mapping of the bank’s lending practices, however, reveals that it provides substantial support to Ghana’s booming small and medium enterprise (SME) sector, which in turn generates thousands of jobs and millions of dollars in local household income and tax revenue. This evidence of impact on the Ghanaian economy, which Standard Chartered reported to the press in 2010, has come as a welcome surprise to government officials and citizens, and even to the bank’s senior management. As a result, the bank’s managers plan to increase lending to the SME and agricultural sectors.

For a final example, consider Heineken International. Dutch in name and origin, few people realize that the company mostly operates as a brewer that produces for local markets, often using local inputs. Heineken’s “domestic flavor” has given it a competitive edge in many places, because the beer is often viewed as homegrown. By mapping out its local impact on employment, incomes, and tax revenues in countries such as Sierra Leone, Rwanda, and Nigeria, Heineken can argue to communities and governments that they are the biggest beneficiaries of the company’s presence and thereby promote brand loyalty. And because of Heineken’s guaranteed demand for crops, farmers have improved access to capital, which enables them to buy better seeds and fertilizer to produce higher and more reliable yields. That, in turn, means higher incomes. The benefits of going local are shared by local farmers, the local Heineken brewery, and governments

that rely heavily on beer sales for tax revenue generation. In the words of Door Plantenga, former managing director of Bralirwa (Heineken Rwanda): “The economic impact assessment showed that there was much more to say about our company than what you would get from its profit and loss statement and balance sheet. An important part of the value chain, Bralirwa generates an income for thousands of Rwandans.”

True, the strategy of local sourcing can easily fall victim to any number of exogenous shocks, whether in the form of tax hikes and other government policy changes, activism from nongovernmental organizations and unions, or the mobilization of the local business community against the multinational’s proposed operations. But many of these shocks can be headed off in advance if managers have mapped out and are in a position to leverage local relationships. By doing so, managers and their firms might discover that they have many supporters who can help them reach their objectives.

INPUT-OUTPUT TABLES

For managers to gain a deeper understanding of how consequential local relationships really are, they must find a way to measure them. One method for doing this is fairly well established, although few firms make active and strategic use of it. It consists of driving the company’s financial statements through the national accounts of the countries where they do business. Let’s call this an exercise in economic mapping, or mapping the economy from the firm’s perspective. The national accounts—and, in particular, the accompanying input-output tables that almost every country produces—basically reconcile what goes into an economy with what goes out from it.

The purpose of input-output tables, created by Nobel Prize-winning economist Wassily Leontief in the first part of the 20th century, is to depict the relationship between production and consumption, or between inputs and final demand, within an economy. Input-output tables show how the output of industry A is an input to industry B. For example, glass, rubber, computer chips, and skilled labor are all inputs to automobiles, which represent a final output. Input-output tables take a matrix form, with inputs shown in the columns and outputs in the rows. The relationship between the industries is usually shown in terms of monetary values. Thus the automobile industry will consume X millions of dollars of glass, Y millions of dollars of rubber, and Z millions of dollars of computer

Newmont’s Impact on Jobs in Ghana, 2009

	Jobs created by Newmont	Jobs created by direct suppliers	Jobs created by indirect suppliers	Jobs created by household consumption	Total jobs created
Newmont Gold Ghana Ltd.	1,700	N/A	N/A	N/A	1,700
Agriculture	0	200	8,000	1,900	10,100
Financial Services	0	1,000	1,800	3,300	6,100
Manufacturing	0	2,300	4,600	3,700	10,600
Trade	0	1,100	11,900	2,800	15,800
Transport and Communication	0	200	1,800	600	2,600
Utilities and Construction	0	300	700	100	1,100
Total	1,700	5,100	28,200	12,400	48,000

In 2009, Newmont Gold Ghana Ltd. employed 1,700 people, but the company’s impact on the Ghanaian economy was much greater. As the table shows, Newmont’s operations were ultimately responsible for creating 48,000 jobs in Ghana. Companies that directly supplied Newmont employed 5,100 people. Companies that supplied Newmont’s direct suppliers employed an additional 28,200 people. And another 12,400 jobs were created at restaurants, retailers, and other companies by the spending of these 35,000 workers.

chips. Again, managers can use input-output tables to gain a deeper understanding of how their operations relate to the economies in which they operate.

Beyond this, and no less important, input-output tables also can give managers a good idea of the multiplier effects associated with production. When the procurement managers of auto manufacturers buy goods and services, they also generate employment in these supporting industries. The firm and its suppliers pay workers who go out and spend money in the economy. All of these economic agents also pay taxes to the government. By putting the company’s financial data in the input-output tables, these myriad economic relationships can be mapped and their overall impacts on employment, household incomes, and tax revenues estimated. You can be sure that the administration of President Barack Obama took these multipliers into account when it decided to save the Big Three automakers from going under. Indeed, firms most often make use of input-output tables to illustrate their effects on the economy—their so-called multiplier effects—when they are seeking government subsidies or policy changes, for example, in the context of major investment decisions.

When we ask senior managers to guess what their company’s overall impact is on the economy in which it operates, they usually don’t have the slightest idea. It’s just not a number that’s relevant to their daily concerns or to the firm’s market share or stock price. And they generally don’t have the foggiest notion of how much employment and household income their operations support among their suppliers and their suppliers’ suppliers. They are quite literally flying blind in the countries where they operate. As a consequence, they are depriving themselves of a potentially valuable management tool for advancing their objectives.

Managers can take the economic road map provided by input-output tables and overlay it on top of their corporate strategy, discovering in the process which domestic actors are most likely to support and promote their firm’s goals based on their interdependencies—as

SABMiller did when it started to work with Ugandan farmers.

This approach may seem like nothing more than common sense until one considers how most companies engage with local communities. All too often, local relationships are handled by staff in a company's public affairs division and fall into the bucket of corporate social responsibility (CSR). These public affairs executives often develop a multitude of philanthropic programs—for example, support for the local symphony and youth sports teams—designed to shape public attitude toward the firm. But these programs are rarely judged on their effectiveness, whether they rely on the firm's core competencies, or whether they are scalable and sustainable.

Further, although CSR spending typically constitutes considerably less than 1 percent of a firm's revenues and has relatively localized impacts at most, a substantially higher percentage—up to 90 percent—may be spent up and down a firm's supply chain, with influences that are felt throughout an entire economy. These suppliers provide all the necessary inputs to an industry, often including distribution and retail services and, in doing so, they create income, jobs, and, not to be overlooked, political influence.

Companies in the fast-moving consumer goods sector find that most of their multiplier effects will be felt in their distribution network. A multinational corporation like Coca-Cola Co., whose direct employment within local plants might be small, nonetheless can provide many thousands of jobs because so much of its business relies on distribution and retail sales. It is those distributors and retailers that can provide critical support to Coca-Cola when it comes time to negotiate with governments about tax and labor policies, because they will feel the pinch of any policy change that results—particularly if it reduces consumption. One way to think of local suppliers is as a political constituency.

Interestingly, some companies have used national input-output tables as a way to estimate their economic impact. But they usually have done so in the context of winning concessions from governments over, for example, tax breaks. Corporate investors like Honda Motor Co. will prepare economic impact studies when seeking incentives from American states that they are considering as a destination for a new car factory. Rarely, however, are economic impact studies used as a way to assess the multiplier effects of the company up and down the supply chain.

Why don't more firms use the input-output tables and map their domestic relationships in the way we suggest? There are several reasons. First, managers view the creation of input-output tables as data-intensive and time-consuming. The process requires the collection of information—about suppliers, for example—not generally required by investors or regulators. Second, it is difficult for managers to spin the data that comes out of this analysis. Stakeholders who see the results may always demand that the firm do more for employment and income generation. As many senior executives have told us, "Why should I put my head above the parapet?" And these studies don't tug at the heartstrings the way CSR reports tend to.

But taking the CSR approach to a firm's domestic stakeholders—including its suppliers—misses the strategic boat in three ways. First, it overlooks the obvious fact that the most important thing companies do for the communities where they operate is contribute

to prosperity, employment, and economic growth. Second, it fails to map and quantify the economic links between companies and their communities. And third, the CSR approach is incapable of unifying corporate strategy with supply chain management. The result is that the firm's local relationships are left underutilized—really, they remain a wasted asset—and corporate strategy is made unnecessarily bereft of potentially crucial constituent support. In other words, all too often CSR is viewed as a means to reduce tensions between businesses and local communities. We believe this approach should be turned on its head. Companies should stress their interdependence with the places they operate and do business.

GOING THE (LOCAL) DISTANCE

In our discussions with senior managers of multinational corporations, we have been surprised that relatively few of them have analyzed their local relationships, despite the fact that the supply chain might be where they make their biggest financial outlays. By running corporate financials through input-output tables, managers can estimate how much employment they are creating and in which supporting industries, how much income they are helping to generate economy-wide, and how much tax revenue their operations are providing to government.

That type of quantitative information, it must be stressed, can be invaluable in discussions with governments and other stakeholders. Indeed, even government officials themselves can learn from this analysis. Mwesigye said of our economic impact study of the Nile Breweries operation: "The report shows the unmistakable benefits that SABMiller's investment in Uganda has brought both to the company and to our country, with 44,000 jobs supported and \$92 million added to Uganda's economy."³

Furthermore, this method permits firms to work with stakeholders on various scenarios and on what the effects of government policy changes would be not just to the company's operations but also to the economy generally. Using this method, one could trace a government's proposed tax hike through the input-output tables to gain a better understanding of, say, the trade-offs between incremental revenue generation and employment. This is often the starting point for much more meaningful interaction with government and a focus on achieving mutually beneficial outcomes.

In short, by mapping the company's relationship to the economy in which it operates, and by leveraging the relationships it discovers in that process, businesses can do much to advance their strategic objectives in particular markets. Looking back at the experience of creating Eagle Lager, Graham Mackay, SABMiller's CEO, said, "A better understanding of your company's socioeconomic impact can help maximize its ability to make a difference through stimulating economic development." ■

Notes

- 1 Stephen Rogers and Lisa Cooley, "Deciding Where to Source: Local, National, Regional, or Global," International Supply Chain Management Conference, 2004.
- 2 Woo-Tsong Lin and Guang-Feng Deng, "Global Versus Local Sourcing for Different Supply Chain Networks: An Analysis of Order Unfulfillment Rates," *International Journal of Services Technology and Management* 7(5/6), 2006: 420-438.
- 3 Ethan B. Kapstein and René Kim, *The Socio-Economic Impact of Nile Breweries in Uganda*, London: SABMiller, 2009.