

# Creating Shared Value through Basic Business Strategy

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FOUNDED IN 1866, and the world's largest milk company since the early 1900s, Nestlé has improved the quality of life for local partners and constituents in developing countries, decreased malnutrition within emerging markets, and contributed to economic development in these countries around the world. Through its 650 agronomists and 3,000 direct buyers, it provides free technical advice and 25 million dollars of micro credit to over 600,000 farmers. Nestlé built its long-term strategy around its commitment to "health and wellness" whereby it supplied milk products in developing countries

while providing training in improved milk production, crop and feed management, hygienic practices, and free breeding assistance. As evidenced in Latin America as early as the 1920s, local farmers embraced the education, training, and commitment from a well-established company who, in return, provided steady income, resulting in an extremely strong brand name. Outside research has shown that no global company matches Nestlé in terms of the public rating of the company in social responsibility, in the developing world as well as globally.

By launching initiatives to ameliorate poverty and nutrition concerns in emerging markets at an early point in the



Street stallholder sells Nestlé dairy products in Cameroon.

company's history, Nestlé spearheaded a global campaign that most major corporations have only recently started thinking about. Nestlé refers to this as its "Creating Shared Value Strategy"—creating value for society as a means to creating value for shareholders. This has been a key element in building brand strength and customer loyalty.

Nestlé is today the world's largest food and beverage company, building rapid growth on a nutrition, health and wellness strategy. It is larger than its next two competitors combined and more recently, it reported sales of over \$100 billion in 2007.

## Milk district model: Implementation strategy

HAVING EMERGED in the late 1800s, Nestlé's original milk district model, developed in Switzerland, initially involved delivering the raw materials needed for an infant food made of grain and milk, and for condensed milk.<sup>1</sup> In order to operate efficiently, Nestlé established contracts with several farmers to ensure a constant supply of materials. As the demand for milk products increased, Nestlé began opening more factories and working with more farmers. As Nestlé began exploring opportunities in emerging markets, the company faced new challenges and was forced to develop a milk production process from scratch. Nestlé utilized its previous work in Australia to develop an efficient process in Latin America which involved securing a milk-producing area, building new factories with little resources, importing appropriate equipment, and training local workers. As the process developed, Nestlé replicated it in other regions including Asia, Africa and the Middle East.

In setting up a milk district, Nestlé focused on negotiating contracts with farmers for twice-daily collection of milk, installing or adapting milk collection and chilling infrastructure, coordinating appropriate transportation from collection centers to the district's factory, and developing a program to continuously improve the overall quality of milk. Contemplating the location of the milk district, Nestlé considered production quantity, production costs, potential income earned from milk production by local farmers versus earning from other alternatives, and competition within the area.

## Impact on poverty reduction

NESTLÉ'S SUCCESS in developing milk districts was largely a result of its continuous presence in the various communities where opportunity was scarce. More specifically, Nestlé entered areas prepared to train the locals, provide long-term jobs, guarantee wages, and develop a quality end-product. According to Nestlé's technical director of global dairy operations, "It is always the most remote area that is the poorest and less developed. So bringing a milk collection center to an area like that is a blessing for the village, and starts the whole economic development of the place." By identifying the regions with the greatest need for assistance, Nestlé fostered a mutually symbiotic relationship with partner countries. Farmers valued the steady income provided by the company which was

used to increase their standard of living while Nestlé valued the long-term commitment and steady supply of milk provided by local farmers.

As a result, Nestlé's initiatives in developing milk districts were a first step towards social responsibility and poverty reduction. Nestlé has since been distinguished for its ability to capitalize on its socially conscious behavior. As Michael Porter and Mark Kramer recognize, "If...corporations were to analyze their prospects for social responsibility using the same frameworks that guide their core business choices, they would discover that CSR can be much more than a cost, a constraint, or a charitable deed—it can be a source of opportunity, innovation, and competitive advantage."<sup>2</sup> Nestlé integrated its corporate objectives into one model that was responsive to poverty alleviation and malnutrition while simultaneously attaining its corporate strategic long-term revenue and profit goals.

## Improved standard of living

### Job Creation

A VITAL ASPECT of Nestlé's long-term strategy involved economic development and job security. By the end of 2004, Nestlé assisted nearly 500,000 dairy farmers supplying Nestlé factories directly. Of the 500K, 130K farmers were in Pakistan, 70K in India, 30K in China, 12K in Morocco, 2K in Uzbekistan, 9K in Sri Lanka, 3.5K in Peru, and 3.5K in Panama. Mostly all the dairy farmers were small-scale producers of milk. More specifically, small-scale producers (producing less than 50 liters/day) contributed to 33 percent of Nestlé's fresh milk supply in a given year, while large-scale producers (producing more than 4,000 liters/day) supplied less than 15 percent of the yearly milk supply.

As consumption of dairy products increased annually, opportunity for farmers expanded and job security became less of a concern.

### Higher disposable income

Nestlé's milk districts generated higher incomes for farmers and the community at large. On average, these milk districts were growing by 2-5 percent annually with some of the districts growing as much as 10 percent. In most regions, over 90 percent of the total cost of milk delivered at the factory was paid to farmers. As consumption of milk products and sales increased dramatically in most emerging markets, farmers were doubling their output and increasing their disposable income. For example, in China, milk sales per farmer had increased by 30 percent from 2002-2005; as a result, farmers earned on average \$300/month; 12x the national average farm income in that country.

Nestlé's business model demonstrated that providing ongoing cash flow to rural areas through private funding and sponsorship improved family living conditions, provided consistent education to children, and cultivated stronger livelihoods. Hans Joehr, Nestlé's corporate head of Agriculture, confirmed that "normally one dollar flowing back to a rural area gives another three or four dollars to the local economy."



## Health and wellness

THE MILK DISTRICT MODEL did not only result in higher income for farmers, but, the district's rigid criteria played an important role in consumer health and nutrition by providing energy, protein, calcium, and other essential vitamins. An improved state of health among local residents also had a positive impact on poverty reduction.

Milk product consumption increased dramatically in most emerging markets, averaging a 2 percent increase per year. The increased consumption of healthier dairy products resulted in lower death rates and an overall improved state of health.

## Prospective growth and sustainability

NESTLÉ'S EARLY PRESENCE in emerging markets gave it a first-mover advantage against its competition. Nestlé created partnerships with local dairy producers as well as farmers, which prevented competition from successfully producing milk products in the same regions. By 2005, Nestlé had sales of \$68 billion, with 500 factories in 83 countries and 247,000 employees around the world.

Nestlé's extensive global network provided the assurance of product development. Additionally, Nestlé's commitment to education, training, and regulation guaranteed the ongoing quality assurance of its milk products.

Ultimately, prospective growth and sustainability will be determined by the company's ability to produce milk products at the same pace as products are consumed. A potential bottleneck that many districts face is the continuous availability of cows and fresh milk. As a result, the price of cows has started to increase significantly. The availability of herds in the future will be a direct determinant of the company's ongoing success.

## Scalability and global application

NESTLÉ'S MANAGEMENT TEAM contemplates whether its success within the dairy industry can be adapted to other food systems. In the late 1900s, Nestlé diversified its business into other ventures such as cosmetics, pharmaceuticals, bottled water, pet food, and ice cream. Diversification in product type has helped balance Nestlé's current activities and helped

counter rising oil prices as well as unstable political and economic conditions.

### Long-term challenge: Water scarcity and limitations on food production

A contemporary hurdle that has the potential to impede Nestlé's success in curtailing poverty and advancing nutritional concerns is the growing crisis in water availability in many parts of the world, and the growing gap between supply and demand for basic commodities, including milk.

This can be attributed to over extraction of water in agriculture (though aggressive pumping) which is not being replaced, water pollution, wastage of water at many levels, and global warming.

For this reason, Nestlé has become a strong advocate for water preservation and proper management. It was a founding member of the United Nations Global Compact Water mandate, and has taken significant actions to reduce its own consumption of water. While increasing its food and beverage production in the last 9 years by 76 percent and at the same time reduced its water consumption by 28 percent.

To guard against the negative impact of green gas emissions on global warming, Nestlé has reduced its greenhouse gas emissions by 17 percent in the last 4 years.

While these environmental constraints can have a limiting impact of food companies, Nestlé has a very long term approach to planning and is better able than most to take precautionary measures which cushion the impact of environmental factors.

Nestlé is also protected by negative occurrences in individual countries due to its superior global presence. It has been rated number one by Barron's magazine for global strength, and is present in virtually every country around the world, with about 500 factories in over 100 countries. With about 1 billion customers daily choosing Nestlé products, it is at the same time operating in a very competitive environment, where consumers can readily choose alternatives.

The Nestlé strategy of Creating Shared Value is one of the factors that have led to its brand strength globally, as well as a philosophy of long term development which raises people out of poverty while creating a cadre of loyal supplies and consumers.

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### Endnotes

- 1 Goldberg, Ray A. & Herman, Kerry. "Nestlé's Milk District Model: Economic Development for a Value-Added Food Chain and Improved Nutrition" ed. *Harvard Business School*.
- 2 Porter, Michael E. & Kramer, Mark R. "Strategy & Society: The Link Between Competitive Advantage and Corporate Social Responsibility" Ed. *HBR Spotlight Making a Real Difference*, 80.