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Business and development

Report of the Secretary-General*

Contents

Chapter		Page
I.	Introduction	2
II.	Trends in entrepreneurial development	2
	A. Entrepreneurial environment	3
	B. Main features of entrepreneurship	4
	C. Financing entrepreneurs	4
III.	Related issues	6
	A. Property rights	6
	B. Knowledge acquisition	7
	C. Regulatory framework and governance	8
IV.	The issue of socially responsible business behaviour	10
	A. Responsibility of business	10
	B. Social responsibility of business as a “near rational” economic choice	11
	C. The role of public opinion	12
	D. Current trends	12

* The present report was submitted after the established deadline owing to the need for extensive consultations with United Nations and non-United Nations entities.

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I. Introduction

1. The present report is submitted in response to General Assembly resolution 54/204 of 22 December 1999 on business and development. The intention of that resolution was to return during the current session of the General Assembly to the debate on business and development on a basis of additional insights into advancing development through (a) partnerships between Governments, multilateral institutions and the private sector; (b) fostering an environment that is conducive to business development; and (c) socially responsible ways to conduct business.

2. At the same time, in the context of searching for strong partnerships in pursuit of development and poverty eradication, in resolution 55/215 of 21 December 2000, entitled "Towards global partnerships", the General Assembly requested a report on the ways and means to enhance cooperation between the United Nations and all relevant partners, in particular the private sector, in order to ensure that globalization becomes a positive force for all. The present report should be read in conjunction with the report of the Secretary-General on cooperation between the United Nations and all relevant partners, in particular the private sector (A/56/323). It will address two key questions: what does it take to secure entrepreneurial development in the world, and what does it take to secure that business behaves in a "socially responsible" way?

II. Trends in entrepreneurial development

3. Entrepreneurship development has become a priority for many policy makers in developed and developing countries alike, in market as well as transition economies. Encouraging entrepreneurship is increasingly perceived as a policy option leading to a higher level of economic development, increased productivity, job creation and promotion of more broad-based participation in productive activities, particularly by the poor and by women.

4. The United Nations system has contributed to the promotion of entrepreneurship and business in developing and transition economies through the intergovernmental processes as well as through policy dialogue, advocacy, research, information, learning and operational activities. The international conferences of the 1990s recognized the crucial role of the private sector, together with other actors of civil society, and of entrepreneurship in achieving the goals of economic, social and environmentally sound development. Agenda 21 looked at ways to strengthen the role of business and industry in sustainable development (chap. 30). The World Summit for Social Development addressed a number of recommendations for achieving social development goals that were aimed at enterprises. The business community participated in the United Nations Conference on Human Settlements (Habitat II) through the World Business Forum. The United Nations is engaged in strengthening its relations with the private sector, further to a specific mandate contained in the Millennium Declaration (General Assembly resolution 55/2; see also resolution 48/180 and the reports of the Secretary-General dated 12 September 1995 (A/50/417) and 3 October 1997 (A/52/428)).

5. Most of the United Nations efforts to promote entrepreneurship focus on the "access" problems faced by small and medium-sized enterprises, that is, access to markets, finance, business skills and technology, which in many cases have been aggravated during the last decade by the intense competition on the global market.

6. For instance, the International Trade Centre has established an extensive programme to help entrepreneurs to access markets. Recognizing that inter-firm cooperation in the form of partnering, networking and clustering can also provide many of the ingredients that entrepreneurs need to grow their businesses, the United Nations Conference on Trade and Development (UNCTAD) is continuing to implement an entrepreneurship programme that assists in developing business skills, accessing finance, partnering and networking. It has also undertaken extensive research of linkages between foreign affiliates of multinational enterprises and local companies in developing countries, with the objective of using such linkages to upgrade the competitive capabilities of the domestic enterprises.[1] The United Nations Industrial Development Organization (UNIDO), for its part, provides a broad range of services to help strengthen private sector representative organizations so that they can offer effective advisory and training services to their members, especially small and medium-sized enterprises. The UNIDO Partnership

Programme was launched in 1998 with the objective of working with the established business community to enhance the competitiveness of small and medium-sized enterprises and facilitate their integration into global value chains.

7. Developing and transition economies are taking steps to encourage entrepreneurship and start-ups of small and medium-sized enterprises. They recognize that these enterprises require only modest amounts of capital to generate employment, spread economic activity throughout the country and help distribute the benefits of economic development.[2] Common to all such initiatives is the assumption that entrepreneurship and economic growth are closely linked.

A. Entrepreneurial environment

8. The degree to which entrepreneurship prevails and the extent to which the potential for business creation is allowed to be realized in a country are considered to be the determining factors in the economic growth of any society. There are environments that favour entrepreneurship and environments that hinder its development. In a recent project, Babson College and the London Business School[3] conducted a study which provides strong evidence in support of the assumption that entrepreneurship and economic growth are closely linked, and that there is substantial variation in the level of entrepreneurial activity between countries.

9. In addition, in analysing the factors that explain differences in the levels of entrepreneurial activity, consistent patterns emerge. The most significant include the following:

(a) The fundamental importance of demographic structure;

(b) The consistent under-representation of women;

(c) Central features of the economic systems, such as the presence of the Government in the economy, levels of taxation, the operation of the labour market and investment in education;

(d) The extent to which individuals perceive there are good opportunities to start a business;

(e) The presence of entrepreneurial capacity (the skills required to start a business);

(f) The availability of early-stage finance, both public and private;

(g) The degree to which entrepreneurial activities are socially acceptable.

10. The following guiding principles of entrepreneurship seem crucial for competitiveness in the global market:

(a) Learning to scan for opportunities;

(b) Learning to recognize the potential of new technology;

(c) Developing a methodology for gathering competitive intelligence;

(d) Developing a network to enable the tapping of the (global) capital markets;

(e) Adapting to local tastes and consumer needs.

11. The central argument of the analysis contained in the Global Entrepreneurship Monitor, an annual publication of the above-mentioned project of Babson College and the London Business School is that national economic growth is a function of two parallel sets of interrelated activities, namely those associated with major established firms and those related directly to the entrepreneurial process. Major firms, often competing in the global market, clearly make a major contribution to economic growth and wealth creation. Their success is determined in part by the national context in which they operate, that is, openness, size and role of government, efficiency of financial markets, level and intensity of technology and research and development, physical infrastructure, management skills, flexible labour market and institutions.

12. However, empirical tests have proven that transactional activity among large firms explains only a portion of the variation in economic growth throughout the world. The entrepreneurial process appears to also account for a significant proportion of the differences in economic prosperity between countries. Entrepreneurial activity is driven by the perception of entrepreneurial opportunities combined with the skills and motivation to exploit them. There is a broad consensus that entrepreneurial activity thrives in a particular context, which includes, inter alia, the availability of finance, government policies and programmes designed to support start-ups, and education and training for entrepreneurship.[4]

B. Main features of entrepreneurship

13. According to the Global Entrepreneurship Monitor 2000, men are twice as likely to be involved in entrepreneurial activity as women. This statement holds true for developing and developed countries alike, although the level of women's participation in entrepreneurship varies largely among them. For example, the male-to-female ratio in France is 12:1, while in Brazil it is 1.6:1. In developing and transition economies, starting and owning a business is especially important for women. They often find themselves without access to jobs in the formal sector, yet increasingly shoulder family financial burdens. Women have proven to be very good credit risks (as has been proven by various micro-lending programmes) and tend to plough back a considerable share of income into human resource development (that is, food, health and education for children). Nevertheless, they face considerable handicaps when competing for scarce resources and services owing to cultural constraints, difficulties in access to legal services and, in some societies, low educational and literacy attainments. Support for women entrepreneurs has typically taken the form of project-centred interventions involving the provision of credit and technical assistance. However, it is recognized that efforts need to shift to improving and strengthening the policy framework and to developing indigenous institutional systems that promote and facilitate women's entrepreneurship development.[5]

14. Local and regional economic, social and institutional conditions have a strong influence on entrepreneurial development. The nature of entrepreneurial activity can vary across subnational regions owing to differences in the general and the specific entrepreneurial framework conditions. The concentration of business activity can be extremely significant from a national standpoint: it is estimated that some 380 clusters of firms in the United States together produce 61 per cent of the country's output. Examples can be found in the industrial districts of northern Italy, Silicon Valley in the United States of America, Silicon Glen (between Glasgow and Edinburgh) in Scotland and the Valencia region in Spain. In developing and transition economies also, great contrasts can be observed between large urban areas showing signs of a dynamic entrepreneurial activity, and most rural areas that lag behind. It has to be noted though that most cluster concentrations of firms have occurred spontaneously rather than as an outcome of public policy. Policy can consolidate some of the benefits of existing or fledgling clusters by ensuring suitable institutional conditions. Furthermore, a number of social problems, such as distressed urban areas or unemployment among minorities, are also highly concentrated geographically and can greatly benefit from a local policy response.[6]

15. Entrepreneurial activity is driven by the perception of entrepreneurial opportunity, supported by the skills and motivation necessary to exploit them. Technological innovation and greater economic liberalization have generated global opportunities, involving new markets and new organization of factors of production. Economic globalization that involves increased mobility of factors of production, goods and services as well as the progress of information and communication technology, have both generated the creation of new economic spaces. They have added a number of new dimensions to the phenomenon of entrepreneurship, that is, diminishing importance of national borders and greater interconnection of markets that stretch beyond a particular region. The advance of information and communication technology has created a new market space, economic cyberspace especially for information and knowledge, and enabled new modes of production and distribution. Physical location becomes less relevant for the digital economy, in the sense that parts of the industry are largely based upon the level of technical education and entrepreneurial skills of its workforce. Whether the firms are located in India, Silicon Valley or London is less important than the ability of the cluster of high-technology firms to network among themselves.

C. Financing entrepreneurs

16. Access to financing is one of the major issues hindering entrepreneurial development around the world. The availability of early-stage financing was found to be highly associated with the level of entrepreneurial activity.[7] Start-up enterprises by definition have no track record, and around half of them are likely to close down within the first five years.[8] Traditional forms for obtaining finance, that is, bank loans, bonds or stock market flotation are often unavailable for the high-risk activity of starting a new venture. The essentially conservative nature of the banking industry precludes its major involvement.[9]

And only a well-established company could expect to meet the requirements for listing on a stock exchange.

17. Entrepreneurs typically obtain funding through venture capital funds or from informal investors (for example, friends, family members, colleagues and neighbours).

Venture capital

18. Classic venture capital is risk money invested in small, fledgling companies with high growth potential. Wherever available, it plays a key role in financing new and growth firms. The venture capital industry emerged to finance high-technology enterprises in developed countries, but the industry is also of relevance to the few developing countries that can offer attractive market niches. It is a rapidly expanding industry. Venture capital disbursements in the United States technology sector alone (Internet communications, electronic components, software and hardware) totalled $1.2 billion in 1990, $2.3 billion in 1995 and $82.6 billion in 2000, which amounts to 36 times the 1995 figure.[10] During the first half of 2001, such investments totalled only $17 billion.[11] The total stock of venture capital funds in two developing and transition regions, Asia and Central and Eastern Europe, rose from $300 million in 1990 to over $7 billion in 1995.[12] Many developing and transition economies lack a pool of entrepreneurs and potential venture capitalists. The UNCTAD secretariat estimated that "the supply of potential venture capital managers in developing countries is virtually non-existent" and that "a good venture capitalist will learn through experience, but this takes time and the poor performance of inexperienced managers will impact on the initial results of a venture capital institution".[13]

19. Even though wealthy families started the venture capital market in the United States, over time it has become dominated by institutions such as university endowments and pension funds, which now contribute around 90 per cent of all venture money. Institutional investors in that country have increasingly recognized that they can earn higher returns for holding an asset class that, compared with stocks and bonds, is relatively illiquid and may not be worth anything for a number of years, if ever. These institutional investors now allocate a fixed proportion of their total holdings to venture capital. The institutionalization of the venture capital industry has meant that it has become less cautious about excessive valuations, in the process financing too many competing ventures with doubtful business prospects.

20. The recent boom in venture capital was initiated to take advantage of the opportunities created by the Internet, but United States venture capital firms are now beginning to see that high-tech entrepreneurs exist in the remotest parts of the world. Entrepreneurs are tapping global markets for more than just funding. A European financial services web site, for instance, could be based in Ireland and run by French and German managers. The United States venture capital industry's success (and this would be a lesson to be heeded by emerging markets) can to a large extent be attributed to the fact that it placed as much emphasis on managing as on financing.

Informal funding

21. In many countries, informal funding represents a major infusion of economic resources in nascent and new firms, in most cases constituting a larger chunk than formal venture capital. Informal investments made by private individuals, friends and family of the fledgling entrepreneurs provided from 54 to 95 per cent of the start-up financial support in major industrialized nations and a number of developing economies.[14] For example, in African countries between 59 and 98 per cent of small and medium-sized enterprises are capitalized through the entrepreneur's personal assets.[15]

22. Some groups of entrepreneurs have limited or no access to formal financing, such as bank credit or venture capital. These entrepreneurs are generally poor and reside mostly in developing countries. The entrepreneurial poor are usually farmers or small traders or producers of goods who need credit to purchase inputs, for example seeds, to start a production cycle, or to invest and expand production. Several arrangements offer financing where formal financial institutions do not. The entrepreneurial poor may have access to informal sources of financing, such as family, friends and moneylenders. These informal financing sources, which play an important role in all parts of the world, are very flexible and, as a rule, have low transaction costs. However, the extent of financial intermediation is small and has limited potential.

23. In recent years, semi-formal institutions, such as microcredit facilities operated by non-governmental organizations, have expanded their role in supporting

micro-entrepreneurs. They have been able to deliver financial services to the poor partly because they have imitated and adapted methods applied in the informal sector. Recently, even a few commercial banks have ventured into lending to the poor by adopting microfinance practices. For example, Bank Rakyat Indonesia, a State-owned bank that operates on a commercial basis, is one of the most successful organizations providing micro-loans for 2.5 million micro-borrowers. Micro-lending schemes have served millions of poor people. The few studies that have investigated the impact of microfinance operations on poverty reduction have found a generally positive impact of credit, particularly if the borrower is a woman. However, while there is evidence of gains in household consumption, nutrition, education and contraceptive use, the impact on asset accumulation, productivity and technology, and hence in achieving a lasting output increase, is less discernible.[16]

III. Related issues

A. Property rights

The concept of property rights

24. As proven, for instance, in a nineteenth century pioneering study of the Montagnes people of Quebec,[17] one can establish a clear relationship between property rights and the growth of economic activities. Economic historians have shown how critical the institution of private ownership is for the development of the economy.

25. The thesis has been reinforced by Hernando de Soto's studies of contemporary developing and transition economies, which seem to demonstrate that the absence of clear property rights in these societies inhibits the growth of credit and consequently retards economic development.[18] According to him, a primary function of property rights is to create incentives for using the transaction that transfers these property rights to respond to emerging externalities (monetary as well as non-monetary external costs/external benefits). Property rights systems — intended as controlled environments that reduce transaction costs — decrease the cost of dealing with assets and increase their value. Property rights function well if supported by the rule of law and an independent judiciary. As mentioned by Adam Smith, an efficient legal system (not just in its nominal architecture) and the way in which it is enforced are fundamental for the good functioning of a market-based economic system. To the extent that it underpins stable property rights, it is considered to represent one of the key components of an enabling economic order, one that impacts positively on entrepreneurial development. Titles to property allow assets to be mortgaged and to be broken up into publicly traded stocks, as well as property management and appraisal with agreed-upon rules that hold across neighbourhoods, towns or regions. They also allow entrepreneurs to participate in the formal economy with the benefit of government recognition.[19]

Property rights and growth

26. De Soto observes further that the lack of success of some developing and transition economies is not due to the lack of assets, but to the lack of well-defined property rights that allow "dead" capital to be turned into "liquid" capital. In most developing countries, land is the fundamental collateral, and although poor people have a certain amount of production and real estate, these resources are commercially and financially invisible. Nobody knows who owns what or where. Often, the entrepreneurial poor have created wealth, sometimes collectively, on a vast scale. However, equally often, this wealth is in the form of informal ownership, it is extralegal, and as such it is commercially and financially invisible. According to de Soto, just the real estate held but not legally owned by the poor in the developing countries of the South and in the European transition economies is worth at least $9.3 trillion.[20] In most of the developing countries, women have particularly limited access to property rights. This radically reduces their participation in the formal economy, limits their capacity to make decisions about production and utilization of income.

27. Only the western industrialized countries and small enclaves of wealthy individuals in developing and transition economies have the capacity to represent assets and, therefore, the ability to use capital efficiently. The invisible infrastructure of "asset management" — taken for granted in developed nations, even though it started to develop a little over 100 years ago — is considered to constitute the missing ingredient in the success of many developing and transition economies in the market economy.

Benefiting from property rights development

28. However, even though conversion of "dead" into "liquid" capital seems like primarily a legal problem, it remains also a political and social issue. Even if formal property rights would give the poor access to their "dead" capital, it does not necessarily follow that they would be able to put the capital to a productive use, owing to a number of potential constraints. Property systems can allow misappropriation of resources. Titles can be used to skim off wealth. Legal systems may not provide the necessary safeguards.[21]

29. In addition, as with any capital, once it is available, its investment must be judicious and productive. If not, this may become a recipe for the banks in the developing countries (in the globalized world — some local, some international) to start owning the farmland. Higher levels of education, development of business skills and generally greater access of people to knowledge would have to go hand in hand with such development.

B. Knowledge acquisition

Knowledge-based networked society

30. Knowledge acquisition goes beyond making education affordable and accessible to all as a way to develop human intelligence, enhance human creativity and in this way build up one of the key human capabilities. It is about ways in which society organizes itself to educate its members, but also to adopt, adapt and create knowledge for use in the production process and in the broader spectrum of life applications. Knowledge creates the basis for raising productivity. It is a source of instruction about things to know, but also about how to do things and how to function in various capacities. While it has always been important and it has always been applied in all walks of life, knowledge more than ever before is the key factor in securing economic growth and a high quality of life.

31. It is important also to understand that, when one talks about moving from an industrial to a networked age,[22] one is talking in effect about networking the sources of information and knowledge. This networked knowledge capacity can then be used in economics, in politics or in everyday life. Knowledge is pervasive and environments rich in knowledge will offer countless opportunities for people to develop and for enterprises to apply it in the production process. Environments poor in knowledge will offer fewer such opportunities and the gap between them and the knowledge-rich environments will quickly become visible as can be measured in human capabilities, in the value of exports of high-technology manufactured goods, in the value of exports of sophisticated services, and eventually in the quality of life.

Knowledge gap vis-à-vis digital gap

32. The discussion about knowledge acquisition and the knowledge gap is mistaken sometimes with the discussion about the digital divide. Surely, the information and communication revolution facilitates the knowledge revolution. Without electronic information and communication technology, the current breakthrough in harvesting, sorting, storing and distributing information and knowledge would not be possible. Knowledge acquisition, however, is more about a public mindset and institutions than about computers alone. People have to start to understand that a vast resource is available to them and that it can make a sea of difference in the way they live and work. They must also accord high social status to the knowledge workers. Otherwise, individuals making decisions about allocating their capabilities will not choose studies or careers connected with knowledge development. Such a public mindset would make all the other necessary steps much easier. Information and knowledge must become available. Barring State secrets and proprietary knowledge (which can be easily defined and protected), a culture of transparency, if necessary supported by regulations, must bring out to the public domain all the knowledge that is available and can be used by others. Institutions must be developed to collect knowledge and make it available in a user-friendly way. Institutions must be developed to create new knowledge. Connectivity is needed, but it is crippled without freedom of speech that assures freedom of content. Education is needed to make people open to the new life opportunities that the increased availability of knowledge brings to them. Finally, an environment conducive to entrepreneurship is needed in order for people to benefit from the economic potential of knowledge.

The importance of technological innovations

33. Technological innovations are a specific manifestation of knowledge. They play a key role in raising productivity and accelerating the rate of

economic growth. Historically, the most rapid economic change has always followed periods of intensive technological innovation that has increased the potential returns from building up financial surpluses. As a matter of fact, by comparing the investment and the growth rates, one can see that there are developing countries that actually have more financial resources than they can use productively. In such cases, a change in the growth profile rather than more financial capital is needed. They have to find ways to increase the productivity of capital and labour via the application of technology.

34. Countries that do not keep up with global technology development often collapse, unable even to maintain their standard of living, much less increase it. They usually depend on a narrow range of exports that lose their profitability in the world economy. The long-term decline in the terms of trade of primary commodities is itself a side-effect of technological innovation.[23]

35. There is no doubt that the current simultaneous shift in technology and in economics, that is, the revolution that engulfs knowledge acquisition and technology development, as well as the global manufacturing system that is the bedrock of economic globalization will exacerbate these trends. In order to make sure that an entrepreneurial country uses its economic potential to the fullest, a dynamic system for knowledge acquisition must be implemented.

C. Regulatory framework and governance

Reform and quality of regulatory framework

36. Regulatory framework establishes a space in which, ideally, society strives towards achieving a high level of human development; in support of this goal, markets allocate resources, produce goods and services, and create wealth. In a globalized economy, such a framework increasingly represents a mix of national and international regulations. Yet, in most cases, whatever their origin, it is still the coercive capacity of the national Government that stands behind the execution of these regulations and it is still the national rather than the global context that prevails in shaping the majority of the elements of the regulatory frameworks.

37. The quality of these regulations matters. As regulations are so diverse, it is difficult to define features of a high-quality regulation. Those who have engaged in regulatory reform[24] are prepared to be guided not by the content of the regulations, but rather by goals that the regulations achieve. However, in generic terms, enhancing performance and increasing cost-efficiency are also used as important yardsticks.

38. In the above discussion of entrepreneurial development, much attention has been devoted to the entrepreneurial framework conditions. If one wants to speak about high-quality entrepreneurial framework conditions, one has to realize that there are two sides to them.

39. To a great extent, the technical side relates to the content and user-friendliness of the prevailing regulatory framework. Therefore, regulations do have to be monitored and revised while keeping both in mind. Regulatory reform is known to have boosted sectoral efficiency and innovation, enhanced economy-wide flexibility and potential growth, increased consumer choice and welfare, and increased governmental effectiveness in maintaining high standards of environmental, consumer and safety protections. It can improve the efficiency of national economies and their ability to adapt to the global change. It can target the reduction of business burdens and increase transparency of the overall regulatory regimes that support entrepreneurship, market entry and economic growth, and in turn produce high-quality jobs. Such reform is particularly meaningful for micro, small and medium-size enterprises. While as a rule they tend to be protected, they also have at their disposal little capacity to deal with the cumulative impact of administrative and other regulations.[25]

The importance of good governance

40. The discussion about the relation between democracy and economic growth has a rich tradition. For a long time, it has seemed inconclusive. However, recent research provides convincing arguments in support of those who have maintained that, in securing lasting economic growth it matters what system of exercising authority prevails in a given country.[26] In other words, the type of governance determines the nature of the interaction between the Government and the market as well as its outcome. Depending on the type of governance, the public goods that the Government buys and the kind of regulations that it enforces, the Government can either augment or undercut the market. Empirical evidence tends to

confirm the hypothesis that democratic governance supports market-augmenting Governments, while undemocratic governance tends to eventually suppress the wealth-creating potential of the market.

The importance of inclusion via representation

41. Systems that are not representative and shut down the conversation with the public at large are condemned to an encompassing interest that is narrow. As a rule in such societies, the most value-creating contracts are upheld, whether in the private or in the public domain. However, ignoring a whole plethora of contracts that are crucially important from the point of view of prosperity but somewhat less valuable would effectively shut down whole markets as well. The creation of a host of growth and development-promoting public goods is being ignored. There is no lobby strong enough to make sure that they are not. The group of people who benefit directly from income and indirectly from redistribution of wealth via public goods is small. There is little chance that such systems can forego the growth and development-retarding exaction on groups of the population that are not attached to the immediate structure of power. If economic success comes in such situations, it tends to depend on building a "hard State", one that has a long-term vision of development and does not adapt its policies to any organized interests. In the long run, even the most effective of them tend to experience difficulties, most often stemming from sub-optimal allocation of financial resources and flight of educated nationals.

42. In contrast, the encompassing interest of democracies tends to be much broader: it extends to the majority. Many enlightened democracies are known to make the qualitative jump and develop a "super-encompassing interest" that goes beyond serving the majority only by taking care of the greater public good. They are more likely to develop a legal system and political order that support, for instance, property rights and the enforcement of contracts in the public domain, and facilitate a lasting and widely used capital market.

43. Such systems, for the same reasons, tend to be more receptive to the reform of regulations and of administrative procedures that keeps up with changing circumstances for conducting business. As stated in the forthcoming World Public Sector Report, "... Governments should take the lead in simplifying procedures and regulations for the registering and licensing of business. Without simplifying bureaucratic procedures and rules to set up business, many developing countries will lag far behind and will remain marginalized in the process of globalization … there needs to be a permanent machinery for consultation with representatives of the private sector on the formulation of relevant policies and monitoring their impact." It is about cutting the red tape, increasing information flows, enforcing greater transparency and lowering the cost of access to markets.

The importance of inclusion via freedom

44. The value of freedom is expressed in two ways:

(a) First, freedom is a pre-condition for the development of human creativity. This has always been an important ingredient of all political, economic and social processes, but it is especially relevant now, when societies have to organize for purposes of benefiting from knowledge. This can happen only in an environment that supports freedom of speech, association and assembly, extended to cyberspace. The creative minds of knowledge workers will not thrive in constrained situations. They will either wane or move on in search of a more liveable state;

(b) Second, it encourages entrepreneurship. Societies that host economies with thousands of entrepreneurs have a much greater chance of economic success in the long run. They simply allow the testing of the future by more "trial and error" economic experiments. There is no way that a society can predict the future and plan for it. This is why a very broad array of economic transactions can cover a lot more possible options than the decisions of any single person or of a limited number of economic agents. The recent "dot com" phenomenon in the industrialized countries is but a repetition of earlier eras of technological revolutions, all embodying certain common characteristics: (a) experimenting; (b) capitalization; (c) management; (d) hyper-competition; and (e) consolidation. In the end, then and now, there has been a predictable number of business failures, but eventually the success stories provided reliable railroad transportation in the nineteenth and twentieth centuries and will no doubt provide information and communication technology connectivity and applications for work and life in the twenty-first century.

IV. The issue of socially responsible business behaviour

A. Responsibility of business

45. The question of "to whom and for what are the business firms responsible?" has many possible answers. The answer that they should be responsible to the public at large for important contributions to many aspects of human development would convert the companies' boards into "society's policemen", a responsibility that today is neither obvious nor easily accepted.

The passive view

46. In discussions about socially responsible business behaviour, the point is often raised that the private sector's greatest contribution to human development is its success in the efficient allocation of resources in the production process and securing in this way the least expensive delivery of the goods and services that people want. This is true if the private sector supports competitive markets and has enough information to allow markets to clear, even in the long run; if the culture industry does not take over the formulation of peoples' tastes and, as a consequence, shape demand in the marketplace; and, if across the society, real incomes are allowed to grow over time. If it is, it indeed creates wealth, a basis for assuring one of the fundamental human capabilities: to have a decent standard of living.

47. One more argument that is repeated equally often stresses the primacy of the shareholders' interest and the maximization of the shareholders' value. This assumes the existence of a diverse shareholder community connected to the firm only by investment objectives. This holds true in parts of the world, but it is not universal. Business firms can be owned by a few strategic investors or they can represent major corporate cross-shareholdings, a joint venture or a family-controlled business in which the family has sold a majority interest to diverse shareholders, but retains a controlling minority. They can be recently privatized companies with large residual government holdings. On top of this, much of the sustained economic growth of the 1990s has been brought about by the transnational flow of institutional portfolio equity investments and foreign direct investment. The inherent threat of the capital flight and the rapidly decreasing duration of shareholdings complicates the picture additionally.[27]

48. One can also argue that if it is true that human intelligence augmented with information and communication technology is becoming the leading factor of production, building up at least part of human development infrastructure may eventually become a bona fide business concern. It can be argued that, if a society wants business to behave in a socially responsible way, government regulation can simply create a legal framework in which certain aspects of such behaviour are mandated under the law. This comes about, though, with difficulty even in the national context. There are important, valid arguments concerning liberty that are involved here. Ideology and politics often blur the discussion about adopting such regulations by making them part of much broader battles.

The changing perspective of business

49. Corporations view risks in two different ways. One way is to view risk as a direct threat to a corporation's cash flow, as a result of liability arising from an activity of a corporation that produces negative externalities. That corporation's legal liabilities may threaten its balance sheet. Another way is to view corporate risk from an "image perspective", or people's reactions to the adverse effects of a corporate activity. The reaction of the public can create immense business risks to the cash flows and asset values of a corporation. A company may lose customers as a result of adverse publicity about its performance. "Loss of reputation", "safeguarding brands", "customer loyalty" and "retention of market share" now rank very high on the list of corporate strategies. Risks can also include the costs of external audits that determine, for example, potential pollution problems and the implementation of mechanisms that reduce contamination and clean-up costs.

50. A more practical answer to the question of "to whom business should be responsible", can be answered by flagging the issue of "accountability". Corporate charters dictate that managers are accountable to directors who, in turn, are accountable to shareholders. This chain of accountability was seldom tested before the early 1990s. As that decade set in, the corporate governance movement embarked on an effort, with a high degree of success, to compel managers who functioned with little regard for

shareholder value to change their ways or find new jobs.

51. The mechanism through which this chain of command is tested is the market capitalization, or very simply the stock price of a firm. The agent through which this mechanism passes through the system is the new global investor, namely the institutional and pension fund investor. In the case of the United States, for example, these investors control approximately half of all United States publicly traded stocks.

52. Externalized costs to the firm will be reflected in the company's stock price, when the market perceives increased risks to future revenues from loss of reputation, lawsuits and fines. As might be expected, such an outcome is confirmed by a recent study by Innovest, a financial advisory firm specializing in environmental finance and investment. The company reviewed the environmental impact of 800 companies over a period of more than two years, ending in March 2000, and classified them into a top half and a bottom half by industry. What it found was that the stock price of the more environmentally friendly top half outperformed the bottom half by 22 percent in global forest products, 16 per cent in United States chemicals, 17 per cent in United States petroleum and 12 per cent in United States electric utilities.[28]

The Global Compact's view

53. The above question about business responsibility constitutes the core of the Secretary-General's Global Compact[29] initiative. It refers to the "shared values and principles" between the United Nations and business. It builds on the positive trends described above. It stresses that pure economic utility, pure economic advantage can go hand in hand with business support for human rights; freedom of association and the right to collective bargaining; elimination of compulsory or child labour; elimination of discriminatory hiring practices; and protection of the natural environment. It stresses that, if and when it does, it creates a win-win situation that secures the self-interest of a corporation and "gives human face to the global market".[30]

B. Social responsibility of business as a "near rational" economic choice

54. In fact, "pure economic utility" exists in the economic textbooks only. To come closer to the real life situation, many economists speak about "near rationality of economic agents".[31] While most of the scientific debate in this area has focused on its wage/unemployment aspects, interesting extrapolations are possible. Of course, these would have to be further tested, but as a minimum, they seem to deserve listing:

(a) First, much of the current thinking on the role that business can or cannot play in addressing issues related to human development, locally and globally, indeed seems to be locked in the oversimplified model of economic utility. It assumes that, in the complex world of business activities, the values, preferences and behaviour patterns to which a business firm refers are one-dimensional and for all practical purposes do not change over time. However, many business choices that are eventually made are "menu-dependent". They consider various immediate and future outcomes and are based not on one factor, but on a broad "opportunity set"[32] of factors;

(b) Second, the above-mentioned values, preferences and behaviour patterns emerge not only from market signals, but also from lessons taught by a community. Public policy might alter them and thereby change business responses to the prevailing or emerging human development situations. There exists a clear interaction between government actions, community norms and individual preferences. In other words, "[people tend to] display a sophistication beyond the [economic] model used to evaluate their behaviour"[33] and while human behaviour always tends to maximize the overall payoff, caring about others as "ends" and not only as "means" to achieve one's advantage may enter and often does enter into calculations related to business activities;[34]

(c) Third, empirical research seems to confirm that business firms have a limited scope and duration, but at the same time relatively wide latitude to deviate from full optimization of economic utility; that is, they can go in the near rational direction without incurring significant economic losses.[35] For instance, a degree of fairness is often factored into business decisions.

55. These points have practical implications. They say that a society has a business sector that by and

large fits into its behaviour the society's readiness to make human solidarity part of their set of values. They say also that a firm may take many steps towards socially responsible behaviour before it encounters negative economic consequences. It says that negative financial consequences may not automatically equal negative economic consequences, especially when one considers the payoff for socially responsible behaviour in the firm's reputation with its clients, respect and trust that it earns in the marketplace and with the public at large.

C. The role of public opinion

56. The problem seems to be elsewhere. Decisions about advancing the role of business in human development in the world are very heavily anchored in the present status quo in which the above-mentioned one-dimensional model of economic behaviour prevails. Decisions to form broad partnerships and to start treating human development as a joint responsibility are very heavily anchored in the assumption that it is mostly the Government's role to promote a large share of human development (for example, health care and education). Finally, such decisions are heavily anchored in the existing backlog of human development. Experience shows that people's expectations of change in heavily anchored situations are small. Thinking big seems inconceivable under such circumstances and therefore is usually not tried, even if sweeping changes are quite feasible.

57. There is a promise in making these issues a subject of a broad public debate that would include Governments, the business community and civil society, locally and globally. The Global Compact has been one important step in this direction. There can and should be more. Such debates can impact directly the behaviour of business firms. They can result in governmental and intergovernmental actions that may not even include regulation but would have a beneficial impact on the prevailing social preferences and would lead to altering the incentives that the community offers to the business firms. They would also reinforce the demand for more transparency of business activities and in this way they would make the public debate broader and better informed.

58. There is a promise also in joining the debate both locally and globally by the knowledgeable, skilled, networked individuals of the information age. Their ability to advocate, network and create domains of shared interest that know no boundaries would constitute a powerful source for shaping the prevailing values, preferences and behaviour patterns. If they espouse the value of human solidarity, the menu of incentives that the society offers the business firm may direct it towards socially responsible behaviour.

D. Current trends

59. All this discussion is not happening in a vacuum. It is becoming accepted as a norm that corporate governance will comply with broader guidelines and frameworks. This starts to impact the valuation of firms by the money market managers. Very recently, such voluntary codes have been adopted in more than 30 countries.[36] There are also notable international efforts, such as the OECD Corporate Performance Guidelines and Principles of Corporate Governance; International Corporate Governance Network and the Commonwealth Association for Corporate Governance Guidelines. In a recent survey of 670 chief executive officers, the major complaint in all regions was not about the existence of regulations, but rather about the lack of harmonization of laws and regulations around the world. There seems to be space for trying to establish a kind of best practice guide for corporate governance as a global public good. Some suggest that a voluntary regulation, similar to the Basle Committee of Banking Standards or an ISO-type corporate quality certification would work best.[37]

60. Of course, the question of content of such harmonized guidelines remains open. Today, while the idea of economic and social stability as a goal to be pursued by long-term corporate strategies is gradually finding its way to the boardrooms, the socially responsible behaviour of business remains far from being assured. It is encouraging, though, that the most reported international cases in recent times that have involved endangering the environment, bribery or inhuman working conditions have been solved as a rule in the way that public opinion has demanded, usually with new codes of conduct adopted by the firms concerned. In at least one of these cases, the management has recorded "a sense of discomfort" among its own staff. People seemed unhappy working for an organization that they did not regard as "ethical".[38]

61. The constituency interested in and ready to respond to business behaviour therefore seems to be broadening. It continues to include the owners of various forms of capital, but it also includes the supplier and customer communities that are crucial to the position of the firm in the marketplace; employment base (especially if it represents a unique strength of expertise and skills); community in which a firm operates; and public opinion at large.

62. The backlog of human development is daunting. No one knows for sure how the composition of actors that can impact human development will look like in the future. There are indications that the structure in which there is one predominant actor (that is, government) and one predominant treasury (that is, public budget) may be replaced with a constellation of actors, public and private, each with its own capacity and treasury, forming ad hoc alliances to solve ad hoc problems. Government organizations, business firms, individuals and formal and informal organizations of civil society could be part of such a constellation. However, the issues on which it will be ready to focus and the solutions that it will apply will remain anchored in the results of public discourse: about values, about societal incentives and about payoffs that a society awards to business for socially responsible behaviour.

Notes

[1] See United Nations Conference on Trade and Development, "Enhancing the competitiveness of SMEs in the context of FDI in developing countries", 2000, (symbol TD/B/COM.3/34); United Nations Conference on Trade and Development, *World Investment Report 2001* (symbol UNCTAD/WIR/2001).

[2] See United Nations Conference on Trade and Development, "Providing sustainable financial and non-financial services for SME development", 16 April 1999 (symbol TD/B/COM.3/EM.7/2).

[3] The Global Entrepreneurship Monitor (GEM) initiative was created in 1997 as a joint initiative by Babson College and the London Business School. A primary objective of the programme is to understand how the entrepreneurial process operates and how its contribution to economic growth varies across countries. Twenty-one countries participated in the study in 2000, of which six were developing economies in three geographic regions (South America, the Middle East and Asia). Built upon a solid research design that involves the collection and analysis of large samples of data in each country, the study focuses on three fundamental questions: (a) Does the level of entrepreneurial activity vary between countries and, if so, how much? (b) Does the level of entrepreneurial activity affect a country's rate of economic growth? (c) What makes a country entrepreneurial?

[4] United Nations Conference on Trade and Development, 1999.

[5] Organisation for Economic Cooperation and Development, "DAC orientation for development cooperation in support of private sector development", OECD document symbol DCD/DAC(93)32/REV2, June 1994; World Bank "Ghana: Financial services for women entrepreneurs in the informal sector" WB Africa Region Findings, No. 136 June 1999; Reynolds, Hay, Bygrave, Camp and Autio "Global Entrepreneurship Monitor — 2000 Executive Report".

[6] Irene Tinagli, "Competing in Europe. A Comparative Study on New Patterns of Development in European Regions" (April 2001); Organisation for Economic Cooperation and Development "Fostering Entrepreneurship", OECD Policy Brief No. 9, 1998.

[7] Global Entrepreneurship Monitor.

[8] Organisation for Economic Cooperation and Development, 1998.

[9] United Nations Conference on Trade and Development, 1999.

[10] Global Entrepreneurship Monitor.

[11] Sources: Venture Economics (www.ventureeconomics.com) and National Vulvodynia Association (www.nva.org).

[12] United Nations, *World Economic and Social Survey,* 1999.

[13] Ibid., 1999.

[14] Global Entrepreneurship Monitor.

[15] United Nations Conference on Trade and Development, "Issues concerning SMEs access to finance", Ad Hoc Working Group on the Role of Enterprises in Development, 1995 (TD/B/WG.7/6).

[16] United Nations, *World Economic and Social Survey*, 1999.

[17] Harold Demsetz, "Toward a theory of property rights", *American Economic Review*, 57, 347-59.

[18] Hernando De Soto, "The mystery of capital", New York, Basic Books, 2000.

[19] Global Entrepreneurship Monitor.

[20] Hernando De Soto, "The mystery of capital", New York, Basic Books, 2000.

[21] United Nations, *World Economic and Social Survey*, 1993.

[22] United Nations Development Programme, *Human Development Report 2001*.

[23] See: “A new map of the world”, *The Economist*, 22 June 2000.

[24] See the Organisation for Economic Cooperation and Development report on regulatory reform, Organisation for Economic Cooperation and Development, Paris, 1997.

[25] Ibid.

[26] See Olson Mancur, “Power and Prosperity. Outgrowing Communist and Capitalist Dictatorships”, Basic Books, 2000.

[27] “Conformance of Performance and Other Dilemmas in Corporate Governance”, a project of the World Economic Forum in partnership with Deloitte Touche Tohmatsu, Davos, Switzerland, 2001.

[28] P. Wilkes at Innovest Strategic Value Advisors (www.innovestgroup.com).

[29] See the Secretary-General’s speech at the World Economic Forum, Davos, Switzerland, 31 January 1999.

[30] Ibid.

[31] For reference, see Amartya Sen, “Rational fools: a critique of the behavioural foundations of economic theory”, Philosophical and Public Affairs, summer 1977; George A. Akerlof and Janet L. Yellen, “Rational models of irrational behaviour”, *American Economic Review*, vol. 77, issue No. 2, May 1987; Daniel M. Hausman and Michael McPherson, “Taking ethics seriously: economics and contemporary moral philosophy”, *Journal of Economic Literature*, vol. XXXI, June 1993; Amartya Sen, “The formulation of rational choice”, *American Economic Review*, vol. 84, issue No. 2, May 1994; Henry J. Aaron, “Public policy, values, and consciousness”, *Journal of Economic Perspectives*, vol. 8, issue No. 2 (spring, 1994); *The Economist*, “Business ethics: doing well by doing good”, 22 April 2000.

[32] Amartya Sen, “The formulation of rational choice”, *American Economic Review*, vol. 84, issue No. 2, May 1994.

[33] Ibid., “Rational fools: a critique of the behavioural foundations of economic theory”, Philosophical and Public Affairs, summer 1977.

[34] Henry J. Aaron, “Public policy, values, and consciousness”, *Journal of Economic Perspectives*, vol. 8, issue No. 2 (spring, 1994).

[35] Akerlof and Yellen, (see note 31) write: “In mathematical terms, this is a consequence of the envelope theorem which states, in effect, that the impact of an exogenous shock of a fully maximizing agent is identical, up to a first order approximation, whether he optimally changes his decision variable in response to a shock, or instead responds inertially. Stated differently, inertial, or rule of thumb behaviour typically imposes losses on its practitioners, relative to rewards from optimizing, which are second-order. Thus, slight relaxation of the standards for “good” model building — so as to tolerate behavioural assumptions entailing suitably small losses from non-maximizing — significantly enlarges the range of behaviour to be considered”.

[36] “Conformance of performance and other dilemmas in corporate governance”, a project of the World Economic Forum in partnership with Deloitte Touche Tohmatsu, Davos, Switzerland, 2001.

[37] Ibid.

[38] *The Economist*, “Business ethics: doing well by doing good”, 22 April 2000.