

## Let business do business: the role of the corporate sector in international development

By Peter Davis

**T**he corporate sector is a major driver of development, yet its role as a development actor remains consigned to the sidelines of the development debate. The donor community has made efforts to work with companies, and a growing number of companies are embracing development-related issues in their standard business practices. However, the private sector still remains tangential to mainstream development policy and practice.

This paper argues that, incomplete though our understanding is, we can define a ‘sweet spot’ that would allow the corporate sector to play a full, strategic and positive role in international development. This revolves around two components:

- creating a regulatory and legal framework that facilitates corporate investment and activity
- developing structures to harness corporations and corporate behaviour that provide the greatest development benefits and that marginalise the corporations and behaviour that damage development.

### What is the corporate sector?

The private sector can include every enterprise, from the huge multinational corporations (MNCs) such as Wal-Mart, Shell and General Motors at one extreme, to farms and enterprises operated by just one person at the other. This paper focuses more narrowly on the ‘corporate sector’, which is understood here to

include MNCs and the larger private companies that are indigenous to developing countries. As will be argued, one of the main ways in which such corporations have an impact on the wider private sector is through their connections with smaller enterprises. Therefore, engagement with the corporate sector can have wider impacts on the value chains of those smaller organisations.

### The impact of the corporate sector on development

Even in the aftermath of the global economic crisis, the flows of foreign investment to developing countries continue to dwarf the flows of official development assistance (ODA). According to World Bank figures, net private capital flows to developing countries in 2010 amounted to \$524.8 billion (UNCTAD, 2011). By comparison, in the same year net ODA disbursements by the 22 member countries of the Development Assistance Committee (DAC) of the OECD totalled \$128.7 billion (OECD, 2011). As the CEO of the mining group Anglo American recently pointed out, her company’s annual procurement spend in developing economies (of around \$7 billion) is comparable to the aid budgets of the UK, France or Germany (Business Action for Africa, 2011).

However the corporate impact goes beyond the simply financial. A 2008 report by a Dutch NGO, the Centre for Research on Multinational Corporations (SOMO), made it clear that the corporate sector has a major impact on a wide range of development issues: economic growth and productivity; poverty reduction, employment creation and human rights; and environmental issues such as pollution and

the management of habitats (van Dijk and Vander Stichele, 2008).

We are beginning to develop a clearer picture of the processes through which the corporate sector impacts on development in host countries. In the case of tourism for example, an ODI review for the World Bank identified three mechanisms of impact:

- the direct effects of tourism – the earnings of those working in the sector, at hotels and in excursion companies
- the indirect effects as tourism draws in inputs from other segments of the economy such as food, transportation and furnishings
- the dynamic effects created by tourism, such as the business climate for small enterprise development; patterns of growth in the host economy, and the infrastructure of the destination (Mitchell and Ashley, 2007).

The developmental impacts of other sectors have also been explored. The telecommunications industry, for example, impacts on development at macro, company and personal levels (Kramer and Katz, 2007). An ODI opinion piece in 2009 also categorised three types of benefit (Singh, 2009). First, incremental benefits to improve the things that people already do. One example might be allowing people to communicate by phone, rather than having to travel. Second, mobile telephony has brought transformational benefits, such as mobile banking and mobile commerce. Third, production benefits create a new source of livelihoods, such as selling air time or phone cards.

Given the proportion of the world's population still engaged in agriculture, the development of the food and beverage sector is particularly important 'in creating both economic and social value,' according to Pfitzer and Krishnaswamy (2007). They write that, as the revenues generated by the industry grow, 'a large portion of the value flows to: farmers involved in raw materials production; ...both direct and indirect labour; governments as taxes....'

The developmental significance of the direct and indirect effects of the corporate sector has been demonstrated by a number of studies. A 2005 examination by Oxfam of Unilever's business in Indonesia found that the company's main operations provided employment for 5,000 people, and supported an estimated further 300,000 jobs in the company's value chain (Clay, 2005). A similar study, carried out in 2008 into Unilever's business in South Africa found that for every job Unilever created in its direct operations, a further 22 were created in the value-chain, representing 0.8% of the country's total employment (Kapstein, 2008).

A recent study, again by Oxfam, of the operations of Coca-Cola and SABMiller in Zambia and El Salvador found similar wealth creating impacts. This work concluded that the gross value added (GVA) by the value chains of these two companies in 2008 was \$ 21 million in Zambia and \$ 83 million in El Salvador. Oxfam calculated that this supported an estimated 3,741 jobs in Zambia, and 4,244 in El Salvador (Oxfam America, 2010).

The dynamic effects of corporate activity are harder to quantify, yet appear to be significant. There is evidence in the tourism sector, for example, that corporate activity can stimulate enterprise development by exposing indigenous entrepreneurs to international tastes. Tourism training can also have positive externalities, as the skills learned within the industry can be used elsewhere in the economy.

There is also good evidence to suggest that the corporate sector has beneficial impacts in terms of governance in developing countries. A study of foreign investment in 100 countries since 1970 has concluded that investors prefer countries that are stable and where democratic institutions and legal safeguards are in place (Jensen, 2006). Countries that want to attract foreign direct investment (FDI), therefore, have an obvious interest in fostering good governance. Similarly, responsible investors are likely to operate in such a way as to contribute to these goods.

Yet the corporate sector's role in development remains controversial. Being large can, in itself, confer monopoly power that allows corporations to make high profits. Some foreign corporations choose to invest in a country because of low wages, unenforced labour legislation, or lack of control of environmental pollution. Companies may also use their size to bribe political leaders and public officials to ensure that they are 'immune' to whatever laws and regulations apply.

The controversy over the development role of the corporate sector is demonstrated by the current debate over corporate land acquisitions in developing countries. Such land acquisitions have been characterised by some campaigners as 'land grabs'(Borras and Franco, 2010), a highly-pejorative term – the choice of which reflects a knee-jerk attitude to corporate activity in low-income countries. Yet the debate is much more nuanced than this response would suggest. Exact figures are disputed, but the World Bank estimates that between 2008 and 2010, 45 million hectares of farmland were bought and sold, compared to an annual average of 4 million hectares per annum before that time (World Bank, 2010).

Critics argue that this development will exacerbate insecurity of tenure for small farmers and damage the economic and social structures of rural

societies (Da Via, 2011). As a result, it is claimed, food insecurity will increase (de Schutter, 2009). Others, however, see this as a welcome development. The World Bank, for example argues that these land investments will ‘help create the pre-conditions for sustained broad-based development [by allowing] land abundant countries to gain access to better technology and more jobs for poor farmers and other rural citizens.’ (World Bank, 2010). A joint paper by the International Institute for Environment and Development (IIED), the Food and Agriculture Organization (FAO) and the International Fund for Agricultural Development (IFAD) also agrees that ‘increased investment may bring macro-level benefits (such as GDP growth and improved government revenues), and may create opportunities for economic development and livelihood improvement in rural areas.’ (Cotula et al., 2009). Outcomes will depend on how such investment is managed by governments. If it can be harnessed, it could be used to deliver economic gains.

### **Harnessing the corporate sector: the challenge for development policy**

So, what makes the corporate sector such a potentially valuable player in development? The reality is that the corporate sector can bring many assets and contributions to development. Companies often have good access to finance and can invest at a scale that others cannot; they may have expert skills and knowledge, even the ability to develop their own technology, taking advantage of their scale. Because they are interested in market growth, they may help to encourage pro-growth policy outcomes and associated governance improvements. They are usually visible to the public and their leaders and they may feel, especially when foreign to the country in which they operate, the need to behave within moral norms that may be more demanding than legislation requires in their treatment of staff, in limiting any environmental harm and in being seen to contribute to the common good. Most developing countries bend over backwards to attract more FDI, given the economic benefits it can bring.

From the public policy perspective therefore, there is a need to allow business to do business. There is a need to create the enabling or investment climate that encourages investment and innovation in economic activity. That, in turn, is about macro-economic management, about fostering institutions that allow business deals, about regulation that respects public values and goods without strangling private initiative, and about supplying the public goods — such as roads, ports, education, health,

clean water and so on — that make it possible for private enterprise to conduct business. Such activities also have the advantage of benefiting the wider private sector.

There is, however, a further and harder challenge: how to manage the corporate sector to harness its power and maximise its positive development impacts, while reining in bad corporate practices that result in negative development impacts. As discussed above, the developmental role of the corporate sector remains controversial. While it can contribute greatly to development, it also has the potential to harm it.

### **Allowing the corporate sector to thrive**

How then should public policy and action respond to the first of these challenges: to establish an environment in which the corporate sector can succeed? Business environment reform and other policy frameworks are well-established processes within the donor community. These need to be used to establish new frameworks that see an improved business environment as an end in itself, but that also links this to the wider development needs of the host country. This can be achieved in the following ways.

#### **The regulatory environment**

We already know that the regulatory environment has a significant role in setting the framework of incentives for companies to allow them not only to operate in a predictable environment, but also to harness their activities to the wider development of the host country (Lin, 2009). The recently-published UN General Principles on Business and Human Rights also make it clear that the legislative framework set by states is of key importance in dealing with the corporate impact on human rights (Ruggie, 2011). This framework argues strongly that protection of human rights (and, by extension, other developmental goods) is the duty of government. As they also make clear, companies have a responsibility to respect human rights. States are expected to develop regulatory and legal structures that oblige the corporate sector to take their duty to respect human rights very seriously.

Appropriate regulation is also needed to stimulate and underpin private investment. The example of the development of green energy demonstrates the important role of appropriate regulation. A Chatham House paper coined the term ‘investment grade energy policy’ as ‘a critical factor for unlocking significantly scaled-up capital flows into renewable energy and energy efficiency’ (Hamilton, 2009).

This term is used to define policy regimes that provide investors with clarity, stability, predictability and long-term visibility for investors.

The emergence of a stable financial sector in Rwanda is another example of how regulation can incentivise corporate activity. Institutional reform of Rwanda's financial sector was undertaken by the Government in collaboration with the international community as one of the priorities in the country's road-map for development, *Vision 2020* (Government of Rwanda, 2020). This included the strengthening of banking sector regulation; the creation of a regulatory framework for microfinance; and establishing a new independent regulator for the insurance industry (World Bank, 2009).

This work provided the basis for foreign banks to move into Rwanda. The result is that, from a banking sector that was on its knees in 2000, a number of thriving banks are now able to offer modern banking services such as electronic bank transfers, cash machines, savings accounts, loans and mortgages. What the banks have done would have been impossible without the prior work of the World Bank and others. Equally, however, what those donors did would have been pointless without corporate banks entering the market and building a modern banking infrastructure.

### **Domestic economic conditions**

Optimising the benefit of international companies requires that they stimulate rather than stymie the development of the local private sector. Whether or not foreign companies encourage or discourage domestic investment in a host economy appears to depend on a number of variables. These include, for example, the strategies of the investing companies and the extent to which they are prepared to share knowledge and expertise with domestic firms (Spencer, 2008).

However, the ability of local firms to absorb the technology and practices presented by foreign companies is also important. Foreign investment, therefore, has greater developmental impacts when domestic firms are larger and the technological gap between them and incoming companies is smaller (Zhang et al., 2010). As a result, there appears to be a case for the use of industrial policy by host governments to ensure that they accept foreign investments that are appropriate to the stage of development of their economy (Narula and Dunning, 2009). Equally, it requires investing companies to be aware of the importance, from a developmental perspective, of technology transfer to host country business partners.

### **Harnessing the good; marginalising the bad**

What, then, of the second challenge: to harness those elements of the corporate sector that aid development, and rein in those practices that damage it? While practice in this area is far less clearly defined than that of the reform of the business environment, there are emerging examples of good practice that provide an increasingly clear impression of how donor agencies encourage those corporations and business practices that work in favour of good development and against those that damage it.

### **Encouraging development-aware corporate business models**

Getting better development outcomes requires the presence of companies that actually see themselves as development actors, and plan their business processes with this in mind. It must be stressed that this approach is very different from the 'corporate social responsibility' agenda (Davis, 2008). Donor agencies need to understand better why it is that some companies are proactive in adopting business approaches that are developmentally beneficial. Porter and Kramer (2011) have argued that companies are in pursuit of some 'higher form of capitalism': there is little evidence that this is the case. Companies innovating in the development space are doing so not for altruistic motives, but to secure profitable growth and protect their licence to operate at existing sites, according to the author's interviews with industry representatives. Some examples include the following:

- **Anglo American:** This mining group has many sites that are in remote rural areas and that have a significant impact on local communities. In order to approach these issues in a systematic fashion, the company developed the Socio-Economic Assessment Toolbox (SEAT), to help operations benchmark and improve the management of issues such as local employment, the inclusion of disadvantaged groups, training, procurement and community social investment.
- **Heineken:** This company has developed a model for economic impact assessment that allows local companies to carry out scenario analyses that enable management teams to include societal opinions in their business decisions more explicitly (Heineken, 2006a). This reflects the company's stated belief that 'lack of economic development and poverty reduction are... one of the most important obstacles to further growth of our business' (Heineken 2006b). The assessment process was piloted in Sierra Leone in 2006, and in Greece and Burundi in 2007.

- **Reuters:** In 2008, news agency Reuters launched a subscription-based service that uses mobile phone SMS technology to provide small farmers with tailored information about 150 crop types in more than 1,000 markets (BCA, 2010). The service, therefore, reduces information asymmetry in agricultural markets and helps small farmers get a greater proportion of the value of their produce. Reuters estimates that the service is now used by more than 300,000 farmers in rural India.

More work is needed to better understand what prompts some companies to adopt more development-aware business approaches. What, for example, caused BP to integrate the Voluntary Principles on Business and Human Rights into their operating systems? If we understood such issues, we would be in a better position to understand what drives companies to pursue commercial strategies that have benign (and malign) developmental impacts.

There is a tendency to see the ‘corporate sector’ as a homogenous set of entities that are all the same, and that can, therefore, provide the same sorts of inputs in development terms. This is not the case: the corporate sector encompasses a wide range of different entities, including large private firms, service companies and partnerships, and portfolio investors operating at different nodes of the value chain between input supply and retail end-markets. These different entities work in different sectors – in oil and gas, mining, retail, manufacturing and so on. As already discussed, it is clear that what the tourist sector brings to development differs from what the telecoms or agricultural sectors bring. We need to explore in more detail the developmental ‘footprint’ of different types of corporate entity, and of entities operating in different sectors

### Symbiotic relationships

The development potential of the corporate sector also appears to be optimised when there is a genuinely symbiotic relationship between the actions taken by the state and corporate actors. Such approaches also recognise that there is a large amount of developmental activity that companies will undertake as part of their core operations: donors need to recognise and harness this.

The ‘Beira Agricultural Growth Corridor’ in Mozambique appears to be one good example of such joined-up thinking on development. This initiative was launched at the World Economic Forum in January 2009 (BAGC 2010) as a venture between the private and public sectors to develop the port of Beira and the trade corridor that services it. The goal is to create ‘a successful and diversified

commercial agriculture sector’ by 2030. From the corporate side, Yara International is investing in a bulk fertiliser handling terminal at the port itself. Further up-country, Tata Steel and Vale are developing the coal fields in Tete province. A Mozambican company, Prio Agriculture is developing land to grow cereals and oil seeds. From the donor side, the African Development Bank is paying to upgrade road infrastructure; while the EU and the World Bank are upgrading the railway network that feeds the port. Back at the port, the Japan International Cooperation Agency and the EU are providing funding to improve dredging capabilities. This coordinated approach optimises the input of all parties.

In most cases however, there is little or no systemic recognition of the impact of the corporate sector in country development plans. In Azerbaijan, for example, the UN Development Assistance Framework (UNDAF) makes no mention of the developmental impact of the oil companies; the Poverty Reduction Strategy Paper for Ghana makes no mention of the mobile phone and mining sectors. Yet in both cases, these sectors represent large percentages of the national economies.

How can the strategic fora in each country be reconfigured to give the corporate sector a voice at the table? If programmes like the Beira corridor can generate such developmental impact at sub-country level, what might be the potential if such an approach of strategic partnership were to be applied at a national or regional level? A number of organisations, including Business Action for Africa, Business Call to Action, and the Business Innovation Facility already bring companies together with suitable project opportunities, and share experience and knowledge. However, this work is often project-based: how can donor agencies reconfigure their approaches to bring this type of activity to the strategic centre of what they do?

Developing such partnerships will also require donors to develop a more sophisticated attitude to risk. Too often, bureaucracies see failures as the result of the absence of adequate planning. Some initiatives, however well planned, may well fail, but this should not make such initiatives too risky to attempt if the potential upside is substantial. Donors need to better understand risk and return when developing or deploying funding sources to promote convergence. There is, of course a need to ensure proper oversight of how public money is used, but in the development space this must not come at the expense of taking well-considered risk.

However, there is also a need for donor agencies to engage the corporate sector at an institutional level. The new strategy from the UK Department

for International Development (DFID) to work more closely with the corporate sector is welcome, yet the fact remains that the primary focus of this and other donors remains ‘development as normal’. In what ways can the corporate sector inform more centrally the decision-making and approach of donor agencies? Many donors use ‘public private partnerships’ in their work, yet these tend to be project-based, transactional relationships.

The case of the UN Global Compact (UNGC) is of particular interest. When Kofi Annan proposed the establishment of the Compact in 1999, he described it as an initiative to ‘bring companies together with UN agencies, labour and civil society to support universal environmental and social principles’ (United Nations, 2000). However, the Global Compact has since become a UN agency in its own right. And there is still little strategic interlinking between the UN’s country planning processes and the corporate sector. How can the UNGC be reconfigured to make these links and engage the corporate sector at a strategic, rather than a tactical, level? Indeed, is the UNGC the correct entity to engage the corporate sector: should this not be done by the individual agencies themselves?

### **Innovative financing**

Optimising the development impact of the corporate sector seems also to require innovation around new types of financing arrangements. A 2010 report by the UN Secretary-General’s Advisory Group on Climate Change Financing made the case for using relatively limited public capital to leverage private investment (United Nations, 2010). Such an approach, they argued, would ‘crowd in’ private capital by compensating investors for lower rates of return. However, as an ODI Background Note makes clear, ‘leveraging through public finance may not, on its own, be sufficient to attract private capital to many low carbon projects.’ (Brown and Jacobs, 2011). The authors argue that further innovations will be needed, such as foreign exchange liquidity facilities, subordinated equity funds and loan guarantees.

Donor agencies have also innovated with ‘challenge funds’ designed to encourage businesses to develop new approaches to development, such as DFID’s Africa Enterprise Challenge Fund (AECF). However, it seems likely that donors will have to be similarly creative in the creation of new approaches to encourage corporate engagement with other areas of development. Historically, agencies have worked primarily through the funding of specific projects in developing countries, or by providing budget support to their central governments.

Donor agencies are beginning to explore other funding mechanisms, as demonstrated by the increased attention being paid to ‘impact investing’. This is defined by the Global Impact Investment Network (GIIN) as ‘investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return.’ (GIIN, 2012)

Ghana’s Venture Capital Trust Fund (VCTF) shows how this approach can leverage additional resources in the pursuit of development aims. Established in 2004, the VCTF aims ‘to provide low cost financing to businesses so they can grow, create jobs and wealth.’ (VCTN, 2012) The Government provided \$15 million in seed funding, and through collaboration with local and foreign investors, the VCTF now has \$55 million in funds under management. Since its inception, the trust estimates that it has financed 3,500 farmers directly, as well as 2,500 others jobs directly, and 4,500 indirectly. To further develop SMEs into large businesses, fund managers will be encouraged to list on the Ghana Stock Exchange.

Impact investing is not without its challenges. For example, how applicable is it in countries with a high predominance of informal business structures and processes, where the costs of formalising a business may be considerable? Even so, the fact that a number of development agencies, such as the CDC Group from the UK, Norway’s Norfund, the International Finance Corporation and the African Development Bank are all exploring this approach is a clear demonstration that there is both considerable interest and scope in finding new financing approaches that leverage the corporate sector in development.

### **Conclusions**

Optimising the role of the corporate sector in development depends not on any one of the different elements described above, but rather on using all of them in a coordinated, coherent and strategic way: a toolbox for engaging the corporate sector.

It is clear that some of these factors are quite well understood – the role of an enabling regulatory environment, for example. Our understanding of some other areas described above remains poor: for example, we lack a detailed understanding of what prompts some companies to build pro-development business approaches.

In addition to the need to develop our knowledge on specific issues, it is also apparent that little or no work has been done to date that sees all these factors (and maybe others) as a nexus that might, collectively, achieve greater and more impactful engagement of the corporate sector in development policy and practice.

The corporate sector is an important driver of development. Despite the global financial crisis, FDI remains nearly five times larger than development aid and, as the example of Unilever has demonstrated, the corporate sector has considerable impacts in terms of jobs and incomes. Yet the corporate sector still remains peripheral to the ‘business’ of the international development community. ‘Corporate engagement’ has been a mantra preached by many bilateral and multilateral agencies, yet strategic collaboration with companies remains very rare.

To change this, donors need to realise that it is not enough to exhort the corporate sector to ‘be better’, or simply to engage companies at a tactical level through, for example, public-private partnership projects, or through initiatives like the Global Compact. Donors need to shift their attitudes and behaviours to recognise that corporations are a vital component in the development process. In short, they need to demonstrate that they are serious about working with the corporate sector. This paper has identified some of the elements that will help change the corporate engagement rhetoric into operational reality.

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