Note

Adapted from a speech given by Mr. McDonough to the Darden Graduate School of Business Administration, December 17, 1996. Copyright 1997 by William A. McDonough. All rights reserved.

Notes

1. Thomas Jefferson, *The Political Writings of Thomas Jefferson*, ed. Merill D. Peterson (Woodlawn: Walk Press, 1993).
2. Rachel Carson, *Silent Spring* (Boston: Houghton Mifflin, 1987).
3. Roderick Nash, *The Rights of Nature: A History of Environmental Ethics* (Madison: University of Wisconsin Press, 1989).
4. Ralph Waldo Emerson, "Nature," *Selections from Ralph Waldo Emerson*, ed. Stephen E. Whicher (Boston: Houghton Mifflin, 1957).
5. Peter Senge, *The Fifth Discipline* (New York: Doubleday, 1991).
6. Tony Hiss and Robert D. Yaro, *A Region at Risk: The Third Regional Plan for the New York-New Jersey-Connecticut Metropolitan Area* (Washington, D.C.: Island Press, 1996).
7. Mr. McDonough has developed and trademarked certain terms to describe his product and systems design protocols. These terms include: *Waste Equals Food, Product of Consumption, Product of Service, Eco-leasing Concept, technical nutrient, downcycling, Cradle-to-Cradle.*
8. See Matthew Mehalik, Michael Gorman, and Patricia Werhane, "DesignTex, Inc.," *Darden Case Bibliography* (Charlottesville, VA: Colgate-Darden School of Business, 1996), and Matthew Mehalik, Michael Gorman and Patricia Werhane, "Rohner Textil, AG," *Darden Case Bibliography* (Charlottesville, VA: Colgate-Darden School of Business, 1997).
9. Paul Hawken, *The Ecology of Commerce: A Declaration of Sustainability* (New York: HarperCollins, 1993).
10. Jane Jacobs, *Systems of Survival: A Dialogue on the Moral Foundations of Commerce and Politics* (New York: Vintage Books, 1992).

Chapter 15

Globalization

Case Study

Global Profits, Global Headaches

MARK BAKER • LAURA HARTMAN • BILL SHAW[1]

K-PAN is a Fort Worth-based Nevada corporation that manufactures and markets textiles. It is a publicly traded firm whose name, for over 50 years, has been synonymous with men and women's work clothes. The last two decades brought great changes to the textile industry. Among other things, labor costs have been on a steep incline. In K-PAN's North Carolina and Texas plants, costs were squeezing profits to the point that K-PAN's board decided to follow its competitors overseas. Over a three year period, K-PAN phased out its domestic operations with a generous re-training and resettlement program for former employees in need of help; built a $28 million state-of-the-art plant in Nicaragua (with $20.5 million in bonds placed by Dillion), and purchased its remaining needs through local agents in Pakistan and Indonesia.

Cost advantages of this globalization effort reflect international differences in labor market conditions, labor laws, producer constraints and environmental restrictions. A typical developing country has higher unemployment levels, lower wage rates, fewer effective labor unions, less effective labor laws, fewer producer constraints, and lower environmental standards. In short, many goods can be produced at a much lower cost in developing countries than in developed countries. By keeping production costs low, sweatshops provide a strong economic incentive for corporations to shift production from developed to developing countries. Increased exports bring jobs for the domestic economy and hard currency for international purchases. As a consequence, the developing county's economy improves along with its standing in world markets.

The worldwide popularity of one of K-PAN's articles of clothing, a pair of pants called "Hangins," put a welcomed spike in its earnings, but also

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focused public attention on the corporation. In doing so, the company came under closer scrutiny, not only from the financial markets, but also from those whose avowed purpose was to monitor MNE's to assure conformance with modern ethical principals.

The adverse publicity that had stunned Nike,[2] The Gap[3] and Kathy Lee,[4] amongst others, began to haunt K-PAN with a vengeance. Ft. Worth residents, supported by a vocal group of former K-PAN employees and the Amalgamated Textile Workers Union, assailed the firm via informational picketing and through the media. In addition to a number of stories in the local media, a group of radical citizens, calling themselves Terrorists Against Multinational Suppressors created and circulated adverse e-mails, some of which had no basis in truth. After some inquiry it became apparent that K-PAN's "model" plant in Nicaragua exhibited a number of shortcomings traditionally associated with "sweatshops" (long hours, low pay, environmental, health, and safety problems). None of these concerns violated the laws of their host country and, in many ways, the plant greatly exceeded local minimum standards in all areas.

However, the negative publicity generated by its Central American operations paled in comparison to the outcry that stemmed from its link with sweatshops in Southeast Asia. Its purchases through local agents in Pakistan and Indonesia allegedly contributed to the perpetuation of atrocious working conditions and poor economic situation in those countries. This predicament was similar to that suffered by Nike in connection with its Indonesian suppliers. A study of Nike workers in Indonesia found that currency devaluation compounded the problems of low wages.

> While workers producing Nike shoes were low-paid before their currency, the rupiah, began plummeting in late 1997, the dollar value of their wages has dropped from $2.47/day in 1997 to 80 cents/day in 1998. Meanwhile, the prices of basic goods have sky-rocketed. Workers reported that they had received a 15 percent pay raise earlier this year, meaning that their base salary had increased from about Rp. 175,000 per month (approximately $17) to about Rp. 200,000 per month (approximately $20). However, they estimated that their cost of living had gone up anywhere from 100 to 300 percent. . . . We found that the cost for a single male worker is $33.20/month and $35/month for a female worker. The base pay for Nike workers, however, is $20/month—not enough to fulfill the basic needs for one worker, much less a family.[5]

K-PAN's insistence that it owned and operated no facilities in those countries couldn't begin to ward off attacks on its corporate policy. K-PAN's internal code of conduct, entitled "K-PAN Ethics," has been in place since 1980 and was patterned after codes of prominent MNE's. Each employee is given a copy of the code, asked to sign it, and subjected to a test on its principles. The central focus of its code had been untouched since it was carefully crafted by K-PAN's founder, Mr. W, as he was widely known. K-PAN ETHICS speaks of a "living wage," "shareholder satisfaction," "community responsibility," and "customer confidence"; these components of the code were met satisfactorily (or at least, they were un-protested) since their inception.

Members of the marketing team came up with the following background information regarding labor conditions in developing economies. Sweatshops are a product of the industrial revolution. Creative entrepreneurs realized that they could earn substantial profits if they could find low-cost labor to operate the new machines. The workers were found when new agricultural practices and the closure of the commons created provided factory owners a growing urban-based pool of workers that could no longer grow what they needed to survive. With few employment opportunities, workers were willing to work long hours under unhealthy conditions for very low pay.

Though business owners were quick to figure out how to keep labor costs low, lexicographers were slow in finding a term to define the owners' shops. The term "sweater" began to be used in the mid-1800s to describe an employer that paid workers very low wages for monotonous work.[6] "Sweatshop" came into use in the late nineteenth century to characterize subcontracting systems where profit margins were increased by "sweating" the workers—requiring employees to work long hours for very little pay.[7] The words sweating and sweatshop crossed the Atlantic as American employers adopted British labor practices.[8]

The Encyclopedia Britannica defines the term *sweatshop* based on a set of employment practices: "a workplace in which workers are employed for long hours at low wages and under unhealthy or oppressive conditions."[9] Several organizations define sweatshops based on compliance with national labor law. According to the U.S. General Accounting Office, a place of work with "an employer that violates more than one federal or state labor, industrial homework, occupational safety and health, workers' compensation, or industry registration law" is a sweatshop.[10] Other groups add to compliance the concept of labor rights. The AFL-CIO Union of Needletrades, Industrial and Textile Employees define sweatshop as a place of employment with "systematic violation of one or more fundamental workers' rights that have been codified in international and U.S. law."[11] Some would say that a variety of sub-standard labor practices needs to be present before a place of employment can be called a sweatshop. Others, such as the Interfaith Center on Corporate Responsibility, require only a single questionable practice: "[though] a factory may be clean, well-organized and harassment free, unless its workers are paid a sustainable living wage, it's still a sweatshop."[12]

The word *sweatshop* is emotive and carries prejudicial connotations. The undercurrent of invoked prejudicial emotions makes it difficult to engage in open, multi-party collaboration to improve working conditions in developing economies. In an effort to deal with these issues, the K-PAN Board of Directors called a special meeting.

"If we forego profits to raise working conditions in the developing world," remarked one board member, "we're just going to have to reduce our purchases and that's going to cost jobs. Who'll be better off?" "Yeah, and our customers won't be happy with the higher prices either. They could switch to Levis or Wranglers. It wouldn't be fair to our shareholders or workers for this to happen," said another. "I really wish all companies worldwide had to adhere to the same rules; that way we'd all be on a level playing field. I wonder if such a set of rules or a proposal exists."

Manuel Smith, a longtime employee who had worked his way up from the factory floor to the Board suggested that they devise a profit-sharing plan designed to keep costs low but to also return profits to every employee of the company. "Let's pay the minimum wage in each country and split the profits with the employees." He liked the incentives this offered.

Claire Harrera, the youngest member of the board and a person of color, reminded her colleagues that "good social work is good business; and a policy of helping workers in developing countries will encourage enlightened consumers to do business with K-PAN, thereby increasing sales; helping costs stay low and maintaining our profits." Her suggestion was to pay all employees at the plant 150% of the local minimum wage, let the world know of the good deed, and require all suppliers to sign and adhere to K-PAN Ethics. Manuel echoed the sentiment of the group when he said, "she's so young and naïve; consumers only care about the bottom line!"

Recognizing that some middle ground must be sought, Professor Dickinson, boyhood pal of the founder and the most recently elected board member, referred members to his recent speech on the topic that included the following remarks:

> Economic growth requires market expansion and market expansion depends on growing product demand. A developing country's export sector is the most likely source of market expansion since its domestic markets will likely not expand until the general economy becomes robust. The International Labor Organization found that the most successful economies have been "those who best exploited emerging opportunities in the global economy. An export-oriented policy is vital in countries that are starting on the industrialization path and have large surpluses of cheap labor."[13]

Whether wages are low, working hours are long, or working conditions are hazardous and unhealthy, the decision to accept employment by a worker in an MNE is not forced slavery but instead made by the employee.[14]

> [I]f the choice is between [meeting] subsistence needs and [having] 'decent' work hours, the work days will be very long. Or if the choice is between child labor on the family farm or a smaller harvest, children will work long and hard in the fields.[15]

Workers wouldn't accept employment if other jobs were more attractive. Research by Sargent and Matthews supports the economists' conclusion. After conducting more than fifty interviews with workers in *maquiladoras* in Mexico, the researchers found that there was no evidence that workers found their present jobs less attractive than other jobs in that economy.[16]

It is not that economists are against better working conditions *per se*. But they are extremely concerned about the manner in which improvements are sought. According to the neoclassicists, improved working conditions will not come from government controls that restrict child labor, raise minimum wage, improve health and safety conditions, allow unionizing, or protect employee rights. At best, governmental controls will improve the working conditions for only a few workers; however, workers in the export industries and throughout the rest of the economy will lose their jobs as exports decline and the economy falters.

Economists argue that the best way to improve working conditions is to leave markets alone.[17] In the short-run, sweatshops give workers a job and some income.[18] In the long-run, an improved economy will give workers the leverage they need to obtain better working conditions. When a developing country's economy grows, the demand for labor increases and provides workers with more employment opportunities. Producers must then offer higher wages, shorter work hours, and other improved working conditions if they want to retain existing workers or attract new workers.

"My God, is any option palatable?" groaned Manuel and the chief financial officer at the same time. The representative of Dillion rolled her eyes and remarked, "The bondholders are going to love us." "Well then," said the professor, "there does exist ethical and economic solutions to our quandary. We just need to be creative and innovative." Someone caught the Chairman's attention and asked, "Can we take a break now?"

The Chairman was about to grant the request, when Kim W. Robins, daughter of the founder interrupted. "I'd like for the Chairman to appoint my sister, my brother, and myself as a committee of the board to look into this matter further and report back at our next meeting."

"So ordered," said the Chair, "we'll hear your report at our West Coast retreat, schedule for the 18th of April in L.A. Meeting adjourned."

Notes

1. Authors names are listed alphabetically.
2. See Bob Herbert, "Nike's Boot Camps," *New York Times* (Mar. 31, 1997), A15.
3. Christian Task Force on Central America, "Urgent Action El Salvador," http://www/grannyg.bc.ca/CTFCA/act1295a.html (Nov. 29, 1995); National Labor Committee, "Gap Agrees to Independent Monitoring Setting New Standard for the Entire Industry," http://www.alfea.it/coordns/work/industria/gap.agrees.html; United Auto Workers, "The Gap Agrees to Improve Conditions in Overseas Plants," *Frontlines*, http://www.uaw.org/solidarity/9601/frontlinesjan96.html (January 1996), p. 1.
4. See Stephanie Strom, "A Sweetheart Becomes Suspect: Looking Behind Those Kathie Lee Labels," *New York Times* (June 27, 1996), D1.
5. Campaign for Labor Rights, *Labor Alerts* (Oct. 16, 1998).
6. http://members.eb.com/bol/topic?eu=72449&sctn=1#s_top. See also H. Braverman, *Labor and Monopoly Capital: The Degradation of Work in the 20th Century* (New York: Monthly Review Press, 1974). The creation of jobs where the primary tasks are routine and repetitive may be considered exploitative in itself.
7. Smithsonian Institution, "The Contracting System," in exhibition: "Between A Rock and A Hard Place: A History of American Sweatshops 1820–Present" (1999) http://www.si.edu/nmah/ve/sweatshops/history/2t35.htm (Subsequent citations to Smithsonian Institution are from same exhibit.) See also "Facts on the Global Sweatshop," *Rethinking Schools* 11, no. 4.
8. Mass migration to America provided factory owners an abundant source of inexpensive labor. Immigrant workers were easy to control because they had limited language skills and a lack of awareness of American labor laws. An Italian folk tale expresses the American immigrant's plight: "Well, I came to America because I heard the streets were paved with gold. When I got here, I found out three things: first, the streets weren't paved with gold; second, they weren't paved at all; and third, I was expected to pave them." http://www.si.edu/nmah/ve/sweatshops/history/2t34.htm (1999). See also Charles Krause, "Labors' Pains," *Online Newshour* (PBS, April 14, 1997) http://www.pbs.org/newshour/bb/business/jan-june97/sweatshops_4-14a.html; Smithsonian Institution, "Tenement Sweatshops" http://www.si.edu/nmah/ve/sweatshops/history/tenement.htm (1999); U.S. Department of Labor, *Dynamic Change in the Garment Industry*, http://www.dol.gov/dol/esa/public/forum/report.htm; L.J. Foo, "The Vulnerable and Exploitable Immigrant Workforce and the Need for Strengthening Worker Protection Legislation," *Yale Law Review* 103, no. 8 (June, 1994), pp. 2179–2212.
9. Encyclopedia Britannica Online Edition, http://members.eb.com/bol/topic?eu=72449&sctn=1#s_top (1999). For a virtually identical definition, see Merriam Webster Dictionary Online Edition, http://www.m-w.com/cgi-bin/dictionary?book=Dictionary&va=sweatshop.
10. http://www.sweatshopwatch.org/swatch/industry/.
11. http://www.uniteunion.org/sweatshops/whatis/infosheet.html.

12. Ruth Rosenbaum, David Schilling, *In Sweatshops, Wages are the Issue* (May 1997).
13. International Labour Organization, *World Employment Report 1995* (Geneva: International Labour Organization, 1995), pp. 75–76, cited in Ian Maitland, "The Great Non-Debate over International Sweatshops," *British Academy of Management Annual Conference Proceedings* (1997), pp. 240–265.
14. See John Sargent and Linda Matthews, "Exploitation or Choice? Exploring the Relative Attractiveness of Employment in the Maquiladoras," *Journal of Business Ethics* 18, no. 2 (Jan. 1999), p. 213. [After conducting more than fifty interviews with workers in *maquiladoras* in Mexico, the researchers found that there was no evidence that workers found their present jobs less attractive that other jobs in that economy.] See also Ian Maitland, "The Great Non-Debate over International Sweatshops," *British Academy of Management Annual Conference Proceedings* (1997), pp. 240–265.
15. Gary S. Fields, "Labor Standards, Economic Development, and International Trade," in *Labor Standards and Development in the Global Economy* (ed. Stephen Herzenberg and Jorge F. Pérez-López) (Washington, D.C.: U.S. Department of Labor Bureau of International Labor Affairs, 1990), pp. 19–20.
16. John Sargent and Linda Matthews, "Exploitation or Choice? Exploring the Relative Attractiveness of Employment in the Maquiladoras," *Journal of Business Ethics* 18, no. 2 (Jan. 1999), pp. 213, 221.
17. Ibid., p. 213 [After conducting more than fifty interviews with workers in *maquiladoras* in Mexico, the researchers found that there was no evidence that workers found their present jobs less attractive that other jobs in that economy.] See also Ian Maitland, *infra* note 14, pp. 240–265.
18. Stephen Golub, "Are International Labor Standards Needed to Prevent Social Dumping?" *Finance & Development* (Dec. 1997), pp. 20, 22.

The Market at the Bottom of the Pyramid

C. K. PRAHALAD

Turn on your television and you will see calls for money to help the world's 4 billion poor—people who live on far less than $2 a day. In fact, the cry is so constant and the need so chronic that the tendency for many people is to tune out these images as well as the message. Even those who do hear and heed the cry are limited in what they can accomplish. For more than 50 years, the World Bank, donor nations, various aid agencies, national governments, and, lately, civil society organizations have all fought the good fight, but have not eradicated poverty. The adoption of the Millennium Development Goals (MDG) by the United Nations only underscores that reality; as we enter the 21st century, poverty—and the disenfranchisement that accompanies it—remains one of the world's most daunting problems.

The purpose of this book is to change that familiar image on TV. It is to illustrate that the typical pictures of poverty mask the fact that the very poor represent resilient entrepreneurs and value-conscious consumers. What is needed is a better approach to help the poor, an approach that involves partnering with them to innovate and achieve sustainable win–win scenarios where the poor are actively engaged and, at the same time, the companies providing products and services to them are profitable. This collaboration between the poor, civil society organizations, governments, and large firms can create the largest and fastest growing markets in the world. Large-scale and wide-spread entrepreneurship is at the heart of the solution to poverty. Such an approach exists and has, in several instances, gone well past the idea stage as private enterprises, both large and small, have begun to successfully build markets at the bottom of the pyramid (BOP) as a way of eradicating poverty.

The economic pyramid of the world is shown in Figure 15-1. As we can see, more than 4 billion constitute the BOP. These are the people who are the subject matter of this book.

THE BOTTOM OF THE PYRAMID (BOP)

The distribution of wealth and the capacity to generate incomes in the world can be captured in the form of an economic pyramid. At the top of the pyramid are the wealthy, with numerous opportunities for generating high levels of income. More than 4 billion people live at the BOP on less than $2 per day. . . .

[There are] companies fighting disease with educational campaigns and innovative products. There are organizations helping the handicapped walk

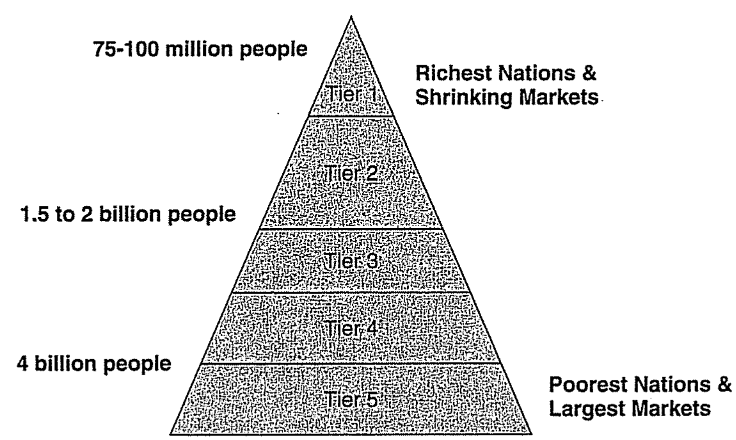

FIGURE 15-1 The economic pyramid.

Source: C. K. Prahalad and Stuart Hart, 2002. The Fortune at the Bottom of the Pyramid, *Strategy + Business*, Issue 26, 2002. Reprinted with permission from *strategy + business*, the award-winning management quarterly published by Booz Allen Hamilton. http://www.strategy-business.com.

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and helping subsistence farmers check commodity prices and connect with the rest of the world. There are banks adapting to the financial needs of the poor, power companies reaching out to meet energy needs, and construction companies doing what they can to house the poor in affordable ways that allow for pride. There are chains of stores tailored to understand the needs of the poor and to make products available to them.

The strength of these innovative approaches, . . ., is that they tend to create opportunities for the poor by offering them choices and encouraging self-esteem. Entrepreneurial solutions such as these place a minimal financial burden on the developing countries in which they occur.

To begin to understand how all of this is remotely possible, we need to start with some basic assumptions:

- First, while cases certainly can be found of large firms and multinational corporations (MNCs) that may have undermined the efforts of the poor to build their livelihoods, the greatest harm they might have done to the poor is to ignore them altogether. The poor cannot participate in the benefits of globalization without an active engagement and without access to products and services that represent global quality standards. They need to be exposed to the range and variety of opportunities that inclusive globalization can provide. The poor represent a "latent market" for goods and services. Active engagement of private enterprises at the BOP is a critical element in creating inclusive capitalism, as private-sector competition for this market will foster attention to the poor as consumers. It will create choices for them. They do not have to depend only on what is available in their villages. If large firms approach this market with the BOP consumers' interests at heart, it can also lead to significant growth and profits for them. These characteristics of a market economy, new to the BOP, can facilitate dramatic change at the BOP. Free and transparent private-sector competition, unlike local village and shanty-town monopolies controlled by local slum lords, can transform the "poor" into consumers (as we illustrate with examples). Poverty alleviation will become a business development task shared among the large private sector firms and local BOP entrepreneurs.
- Second, the BOP, as a market, provides a new growth opportunity for the private sector and a forum for innovations. Old and tired solutions cannot create markets at the BOP.
- Third, BOP markets must become an integral part of the work of the private sector. They must become part of the firms' core businesses; they cannot merely be relegated to the realm of corporate social responsibility (CSR) initiatives. Successfully creating BOP markets involves change in the functioning of MNCs as much as it changes the functioning of developing countries. BOP markets must become integral to the success of the firm in order to command senior management attention and sustained resource allocation.

There is significant untapped opportunity for value creation (for BOP consumers, shareholders, and employees) that is latent in the BOP market. These markets have remained "invisible" for too long.

It is natural for you to ask this: If all of this is so obvious, why has this not yet occurred?

THE POWER OF DOMINANT LOGIC

All of us are prisoners of our own socialization. The lenses through which we perceive the world are colored by our own ideology, experiences, and established management practices. Each one of the groups that is focusing on poverty alleviation—the World Bank, rich countries providing aid, charitable organizations, national governments, and the private sector—is conditioned by its own dominant logic. Let us, for example, examine the dominant logic of each group as it approaches the task of eradicating poverty.

Consider, for instance, the politicians and bureaucrats in India, one of the largest countries with a significant portion of the world's poor. India is home to more than 400 million people who qualify as being very poor. The policies of the government for the first 45 years since independence from Great Britain in 1947 were based on a set of basic assumptions. Independent India started with a deep suspicion of the private sector. The country's interaction with the East India Company and colonialism played a major part in creating this mindset. The experience with the indigenous private sector was not very positive, either. The private sector was deemed exploitative of the poor. This suspicion was coupled with an enormous confidence in the government machinery to do what is "right and moral." For example, the government of India initiated a series of large industrial projects in the public sector (owned by the Indian government) in a wide variety of industries, from steel to food distribution and global trading in essential commodities. India's general suspicion of the private sector led to controls over its size and expansion. Some sectors of economic activity were reserved for small-scale industries. In textiles, for example, the "hand loom sector" dominated by small firms was given preference. There was no credible voice in public policy for nurturing market-based ecosystems that included the large and the small in a symbiotic relationship. The thinking was cleanly divided among the public sector (mostly large firms with significant capital outlay as in steel), the private sector with large firms strictly controlled by the government through a system of licenses, and a small-scale sector. The focus of public policy was on distributive justice over wealth creation. Because of the disparities in wealth and the preponderance of the poor, the government thought its first priority must be policies that "equalized" wealth distribution. Taxation, limits on salaries of top managers, and other such measures were instituted to ensure distributive justice. The discussion further polarized around the somewhat contrived concepts of rural poor and urban rich. The assumption was that the rural population was primarily poor and the urban population was relatively rich. However, the data increasingly does not support this distinction. There are as many rural rich as there are urban poor. Poverty knows no such boundaries. In the developing world, more than one third of the urban population lives in shanty towns and slums. These traditional views reflect the philosophy behind actions taken by bureaucrats and politicians. During the last decade, a slow but discernable transition has been taking place from the traditional to a more market-based outlook.

This much-needed and desirable transition is in its infancy. The dominant logic, built over 45 years, is difficult to give up for individuals, political parties, and sections of the bureaucracy. This is the reason why politicians and bureaucrats appear to be vacillating in their positions. Most thinking people know where they have to go, but letting go of their beliefs and abandoning their "zones of comfort" and familiarity are not easy. We also believe that it is equally difficult for a whole generation of BOP consumers to give up their dependence on governmental subsidies.

We have explicitly focused on ideology and policy and not on the quality of implementation of projects focused on the poor, be it building roads and dams or providing basic education and health care. The distinct role of corruption, which seems so endemic to developing countries in general, deserves separate treatment.

Private-sector businesses, especially MNCs (and large local firms that emulate their MNC competitors), also suffer from a deeply etched dominant logic of their own, which restricts their ability to see a vibrant market opportunity at the BOP. For example, it is common in MNCs to have the assumptions outlined in Table 15.1. These assumptions dictate decision and resource allocation processes for developing countries and BOP markets in particular.

These and other implicit assumptions surface in every discussion of BOP markets with managers in MNCs and those in large domestic firms in developing countries that fashion their management practices after those at successful MNCs. These biases are hard to eradicate in large firms. Although the dominant logic and its implications are clear, it is our goal in this book to challenge and provide counterpoints. For example, BOP markets enable firms to challenge their perspectives on cost. We will show that a 10 to 200 times advantage (compared to the cost structures that are oriented to the top of the pyramid markets) is possible if firms innovate from the BOP up

TABLE 15.1 The Dominant Logic of MNCs as It Relates to BOP

Assumption	Implication
The poor are not our target customers; they cannot afford our products or services.	Our cost structure is a given; with our cost structure, we cannot serve the BOP market.
The poor do not have use for products sold in developed countries.	We are committed to a form over functionality. The poor might need sanitation, but can't afford detergents in formats we offer. Therefore, there is no market in the BOP.
Only developed countries appreciate and pay for technological innovations.	The BOP does not need advanced technology solutions; they will not pay for them. Therefore, the BOP cannot be a source of innovations.
The BOP market is not critical for long-term growth and vitality of MNCs.	BOP markets are at best an attractive distraction.
Intellectual excitement is in developed markets; it is very hard to recruit managers for BOP markets.	We cannot assign our best people to work on market development in BOP markets.

Adapted from C. K. Prahalad and Stuart Hart, The Fortune at the Bottom of the Pyramid, *Strategy + Business*, Issue 26, 2002. Reprinted with permission from *strategy + business*, the award-winning management quarterly published by Booz Allen Hamilton. http://www.strategy-business.com.

and do not follow the traditional practice of serving the BOP markets by making minor changes to the products created for the top of the pyramid.

Most charitable organizations also believe that the private sector is greedy and uncaring and that corporations cannot be trusted with the problems of poverty alleviation. From this perspective, profit motive and poverty alleviation do not mix easily or well. Aid agencies have come full circle in their own thinking. From aid focused on large infrastructure projects and public spending on education and health, they are also moving toward a belief that private-sector involvement is a crucial ingredient to poverty alleviation.

Historically, governments, aid agencies, nongovernmental organizations (NGOs), large firms, and the organized (formal and legal as opposed to extralegal) business sector all seem to have reached an implicit agreement: Market-based solutions cannot lead to poverty reduction and economic development. The dominant logic of each group restricts its ability to see the market opportunities at the BOP. The dominant logic of each group is different, but the conclusions are similar. During the last decade, each group has been searching for ways out of this self-imposed intellectual trap. To eradicate poverty, we have to break this implicit compact through a BOP-oriented involvement of the private sector.

We have to change our long-held beliefs about the BOP—our genetic code, if you will. The barrier that each group has to cross is different, but difficult nonetheless. However, once we cross the intellectual barrier, the opportunities become obvious. The BOP market also represents a major engine of growth and global trade, as we illustrate in our subsequent stories of MNCs and private firms from around the world.

THE NATURE OF THE BOP MARKET

The nature of the BOP market has characteristics that are distinct. We outline some of the critical dimensions that define this market. These characteristics must be incorporated into our thinking as we approach the BOP.

There Is Money at the BOP

The dominant assumption is that the poor have no purchasing power and therefore do not represent a viable market.

Let us start with the aggregate purchasing power in developing countries where most of the BOP market exists. Developing countries offer tremendous growth opportunities. Within these markets, the BOP represents a major opportunity. Take China as an example. With a population of 1.2 billion and an average per capita gross domestic product (GDP) of US $1,000, China currently represents a $1.2 trillion economy. However, the U.S. dollar equivalent is not a good measure of the demand for goods and services produced and consumed in China. If we convert the GDP-based figure into its dollar purchasing power parity (PPP), China is already a $5.0 trillion economy, making it the second largest economy behind the United States in PPP terms. Similarly, the Indian economy is worth about $3.0 trillion in PPP terms. If we take nine countries—China, India, Brazil, Mexico, Russia, Indonesia, Turkey, South Africa, and Thailand—collectively they are home to about 3 billion people, representing 70 percent of the developing world population. In PPP terms, this group's GDP is $12.5 trillion, which represents 90 percent of the developing world. It is larger than the GDP of Japan, Germany, France, the United Kingdom, and Italy combined. This is not a market to be ignored.

Now, consider the BOP within the broad developing country opportunity. The dominant assumption is that the poor do not have money to spend and, therefore, are not a viable market. Certainly, the buying power for those earning less than US $2 per day cannot be compared with the purchasing power of individuals in the developed nations. However, by virtue of their numbers, the poor represent a significant latent purchasing power that must be unlocked. For example, all too often, the poor tend to reside in high-cost ecosystems even within developing countries. In the shanty town of Dharavi, outside Mumbai, India, the poor pay a premium for everything from rice to credit. Compare the cost of everyday items of consumption between Dharavi and Warden Road (now redesignated B. Desai Road), a higher income neighborhood in Mumbai. The poverty penalty in Dharavi can be as high as 5 to 25 times what the rich pay for the same services (Table 15.2). Research indicates that this poverty penalty is universal, although the magnitude differs by country. The poverty penalty is the result of local monopolies, inadequate access, poor distribution, and strong traditional intermediaries. Large-scale private-sector businesses can "unlock this poverty penalty." For example, the poor in Dharavi pay 600 to 1,000 percent interest for credit from local moneylenders. A bank with access to this market can do well for itself by offering credit at 25 percent. Although 25 percent interest might look excessive to a casual observer, from the point of view of the BOP consumer, access to a bank decreases the cost of credit from 600 percent to 25 percent. The BOP consumer

TABLE 15.2. The Poor and High-Cost Economic Ecosystems

Item	Dharavi	Warden Road	Poverty Premium
Credit (annual interest)	600–1,000%	12–18%	53.0
Municipal grade water (per cubic meter)	$1.12	$0.03	37.0
Phone call (per minute)	$0.04–0.05	$0.025	1.8
Diarrhea medication	$20.00	$2.00	10.0
Rice (per kg)	$0.28	$0.24	1.2

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is focused on the difference between the local moneylender rates and the rates that a commercial bank would charge. The bank can make a reasonable profit after adjusting for risk (10 percent over its traditional, top-of-the-pyramid customers). We argue later that the BOP consumers do not represent higher risk.

These cost disparities between BOP consumers and the rich in the same economy can be explained only by the fact that the poverty penalty at the BOP is a result of inefficiencies in access to distribution and the role of the local intermediaries. These problems can easily be cured if the organized private sector decides to serve the BOP. The organized sector brings with it the scale, scope of operations, and management know-how that can lead to efficiencies for itself and its potential consumers.

The poor also spend their earnings in ways that reflect a different set of priorities. For example, they might not spend disposable income on sanitation, clean running water, and better homes, but will spend it on items traditionally considered luxuries. Without legal title to land, these residents are unlikely to invest in improving their living quarters, much less the public facilities surrounding their homes. For example, in Dharavi, 85 percent of the households own a television set, 75 percent own a pressure cooker and blender, 56 percent own a gas stove, and 21 percent have telephones. In Bangladesh, women entrepreneurs with cell phones, which they rent out by the minute to other villagers, do a brisk business. It is estimated that the poor in Bangladesh spend as much as 7 percent of their income on connectivity.

Access to BOP Markets

The dominant assumption is that distribution access to the BOP markets is very difficult and therefore represents a major impediment for the participation of large firms and MNCs.

Urban areas have become a magnet for the poor. By 2015 there will be more than 225 cities in Africa, 903 in Asia, and 225 in Latin America. More than 368 cities in the developing world will have more than 1 million people in each. There will be at least 23 cities with more than 10 million residents. Collectively, these cities will account for about 1.5 to 2.0 billion people. Over 35 to 40 percent of these urban concentrations will be comprised of BOP consumers. The density of these settlements—about 15,000 people per hectare—will allow for intense distribution opportunities.

The rural poor represent a different problem. Access to distribution in rural markets continues to be problematic. Most of the rural markets are also inaccessible to audio and television signals and are often designated as "media dark." Therefore, the rural poor are not only denied access to products and services, but also to knowledge about what is available and how to use it. The spread of wireless connectivity among the poor might help reduce this problem. The ability to download movie and audio clips on wireless devices might allow firms to access traditionally "media dark" areas and provide consumers in these locations with newfound access to information about products and services. However, this is still an evolving phenomenon restricted to a few countries.

The BOP does not lend itself to a single distribution solution. Urban concentrations represent a problem distinct from that of the distribution access to dispersed rural communities. Worldwide, the cost of reach per consumer can vary significantly across countries. A wide variety of experiments are underway in these markets to find efficient methods of distributing goods and services. One such experiment, Project Shakti at Hindustan Lever Ltd. (HLL) in India, is a case in point. HLL created a direct distribution network in hard-to-reach locales (markets without distribution coverage through traditional distributors and dealers). HLL selected entrepreneurial women from these villages and trained them to become distributors, providing education, advice, and access to products to their villages. These village women entrepreneurs, called Shakti Amma ("empowered mother"), have unique knowledge about what the village needs and which products are in demand. They earn between Rs. 3,000 and 7,000 per month (U.S. $60–$150) and therefore create a new capacity to consume for themselves and their families. More important, these entrepreneurial women are increasingly becoming the educators and access points for the rural BOP consumers in their communities. This approach is not new. Avon is one of the largest cosmetics operations in Brazil and has used a similar approach by leveraging more than 800,000 "Avon ladies" as distributors to reach even the most remote regions of Amazonia.[1]

The BOP Markets Are Brand-Conscious

The dominant assumption is that the poor are not brand-conscious. On the contrary, the poor are very brand-conscious. They are also extremely value-conscious by necessity.

The experience of Casas Bahia in Brazil and Elektra in Mexico—two of the largest retailers of consumer durables, such as televisions, washing machines, radios, and other appliances—suggests that the BOP markets are very brand-conscious. Brand consciousness among the poor is universal. In a way, brand consciousness should not be a surprise. An aspiration to a new and different quality of life is the dream of everyone, including those at the BOP. Therefore, aspirational brands are critical for BOP consumers. However, BOP consumers are value buyers. They expect great quality at prices they can afford. The challenge to large firms is to make aspirational products affordable to BOP consumers. These consumers represent a new challenge for managers with increased pressure on costs of development, manufacturing, and distribution. As a result, BOP markets will force a new level of efficiency in the MNCs. . . .

The BOP Market Is Connected

Contrary to the popular view, BOP consumers are getting connected and networked. They are rapidly exploiting the benefits of information networks.

The spread of wireless devices among the poor is proof of a market at the BOP. For example, by the end of 2003, China had an installed base of 250 million cell phones. India had an installed base of approximately 30 million. The Indian market is growing at about 1.5 million handsets per month. The expectation is that India will reach 100 million handsets by 2005. Brazil already has 35 to 40 million. Both the current market size and the growth rates suggest that the BOP market is a critical factor in worldwide wireless growth. Telecommunications providers have made it easier for BOP consumers to purchase handsets and service through prepaid cards. The proliferation of wireless devices among the poor is universal, from Grameen Phone in Bangladesh to Telefonica in Brazil. Further, the availability of PCs in kiosks at a very low price per hour and the opportunity to videoconference using PCs are adding to the intensity of connectivity among those at the BOP. The net result is an unprecedented ability of BOP consumers to communicate with each other in several countries. The technology of wireless and PC connectivity is allowing the BOP population to be actively engaged in a dialogue with each other, with the firms from which they wish to purchase goods and services, and with the politicians who represent them.

Connectivity also allows the BOP consumers to establish new patterns of communication away from their villages. With cell phones and TV, the BOP consumer has unprecedented access to information as well as opportunities to engage in a dialogue with the larger community. As a result, word of mouth among BOP consumers is becoming a very potent force for assessing product quality, prices, and options available to them. The spread of good bargains as well as bad news can be very rapid. For example, in India, it appears that some consumers found worms in chocolates sold by Cadbury, a large and very successful MNC. Ten years ago this would have been a non-event, but with access to multiple and fiercely competitive TV channels, wireless, and Internet, the news spread so rapidly across India that not just managers within Cadbury but all managers involved in the "fast-moving consumer goods" industry were surprised and worried.[2]

BOP Consumers Accept Advanced Technology Readily

Contrary to popular belief, the BOP consumers accept advanced technology readily.

The spread of wireless devices, PC kiosks, and personal digital assistants (PDAs) at the BOP has surprised many a manager and researcher. For example, ITC, an Indian conglomerate, decided to connect Indian farmers with PCs in their villages. The ITC e-Choupal (literally, "village meeting place") allowed the farmers to check prices not only in the local auction houses (called mandis), but also prices of soybean futures at the Chicago Board of Trade. The e-Choupal network allowed the farmers access to information that allowed them to make decisions about how much to sell and when, thus improving their margins. Similarly, women entrepreneurs in southern India, given a PC kiosk in their villages, have learned to videoconference among themselves, across villages on all kinds of issues, from the cost of loans from various banks to the lives of their grandchildren in the

United States.[3] Chat rooms are full of activity that none of us could have imagined. Most interestingly, in Kerala, India, fishermen in traditional fishing boats, after a day of productive work, sell their catch to the highest bidders, using their cell phones to contact multiple possible landing sites along the Kerala coast. The simple boats, called catamarans, have not changed, but the entire process of pricing the catch and knowing how to sell based on reliable information has totally changed lives at the BOP.[4] The BOP consumers are more willing to adopt new technologies because they have nothing to forget. Moving to wireless from nothing is easier than moving to wireless from a strong tradition of efficient and ubiquitous landlines. . . .

THE MARKET DEVELOPMENT IMPERATIVE

The task of converting the poor into consumers is one of market development. Market development involves both the consumer and the private-sector firm. We consider the risks and benefits to the private-sector firm later. Here, we reflect on the incentives for the BOP consumer, who is so far isolated from the benefits of access to regional and global markets, to participate. What are the benefits to the BOP consumer? . . .

Create the Capacity to Consume

To convert the BOP into a consumer market, we have to create the capacity to consume. Cash-poor and with a low level of income, the BOP consumer has to be accessed differently.

The traditional approach to creating the capacity to consume among the poor has been to provide the product or service free of charge. This has the feel of philanthropy. As mentioned previously, charity might feel good, but it rarely solves the problem in a scalable and sustainable fashion.

A rapidly evolving approach to encouraging consumption and choice at the BOP is to make unit packages that are small and, therefore, affordable. The logic is obvious. The rich use cash to inventory convenience. They can afford, for example, to buy a large bottle of shampoo to avoid multiple trips to the store. The poor have unpredictable income streams. Many subsist on daily wages and have to use cash conservatively. They tend to make purchases only when they have cash and buy only what they need for that day. Single-serve packaging—be it shampoo, ketchup, tea and coffee, or aspirin—is well suited to this population. A single-serve revolution is sweeping through the BOP markets. For example, in India, single-serve sachets have become the norm for a wide variety of products, as shown in Table 15.3.

The number of products sold in the single-serve format is rapidly increasing. The format is so popular that even firms producing high-end merchandise have to adopt it to remain viable long-term players in the growing markets. . . .

Measured in tons, the size of the Indian shampoo market is as large as the U.S. market. Large MNCs, such as Unilever and Procter & Gamble (P&G), are major participants in this market, as are large local firms. Because the poor are just as brand-conscious as the rich, it is possible to buy

TABLE 15.3. Creating the Capacity to Consume: Single-Serve Resolution

Single-Serve Value at Retail		
Rs.	$	Typical Products
0.50	0.01	Shampoo, confectionary, matches, tea
1.00	0.02	Shampoo, salt, biscuits, ketchup, fruit drink concentrate
2.00	0.04	Detergent, soap, mouth fresheners, biscuits, jams, spreads, coffee, spices
5.00	0.10	Biscuits, toothpaste, color cosmetics, fragrance, bread, cooking oil, skin cream

Note: Shampoo and biscuits are shown under different price ranges because these items are available in multiple single-serve and low unit pack quantities.

Pantene, a high-end shampoo from P&G, in a single-serve sachet in India. The entrepreneurial private sector has created a large market at the BOP; the penetration of shampoo in India is about 90 percent.

A similar approach to creating capacity to consume is through innovative purchase schemes. More BOP consumers in Brazil are able to buy appliances through Casas Bahia because the firm provides credit even for consumers with low and unpredictable income streams. Through a very sophisticated credit rating system coupled with counseling, Casas Bahia is able to provide access to high-quality appliances to consumers who could not otherwise afford them. At the same time, the firm ensures that its consumers are not overstretched. The default rate is very low at 8.5 percent, compared to over 15 percent for competitor firms. Casas Bahia has also created a new pool of repeat customers. Cemex, one of the world's largest cement companies in Mexico, follows a similar approach in its "do-it-yourself" business focused on the BOP market. The idea is to help the consumers learn to save and invest. By creating a pool of three women who save as a group and discipline and pressure each other to stay with the scheme, Cemex facilitates the process of consumption by bundling savings and access to credit with the ability to add a bathroom or a kitchen to their homes.

Creating the capacity to consume is based on three simple principles best described as the "Three As":

1. Affordability. Whether it is a single-serve package or novel purchasing schemes, the key is affordability without sacrificing quality or efficacy.
2. Access. Distribution patterns for products and services must take into account where the poor live as well as their work patterns. Most BOP consumers must work the full day before they can have enough cash to purchase the necessities for that day. Stores that close at 5:00 PM have no relevance to them, as their shopping begins after 7:00 PM. Further, BOP consumers cannot travel great distances. Stores must be easy to reach, often within a short walk. This calls for geographical intensity of distribution.

3. Availability. Often, the decision to buy for BOP consumers is based on the cash they have on hand at a given point in time. They cannot defer buying decisions. Availability (and therefore, distribution efficiency) is a critical factor in serving the BOP consumer.

Of course, the ideal is to create the capacity to earn more so that the BOP consumers can afford to consume more. The ITC e-Choupal story illustrates how farmers with access to the Internet and thereby access to the prices of commodities around the world can increase their incomes by 5 to 10 percent. These farmers can decide when and how much to sell based on their understanding of the likely price movements for their products. Modern technology not only allows them to realize better prices, but also to improve their logistics. The aggregation of food grains allows for efficiencies for both the farmer and the buyer.

By focusing on the BOP consumers' capacity to consume, private-sector businesses can create a new market. The critical requirement is the ability to invent ways that take into account the variability in the cash flows of BOP consumers that makes it difficult for them to access the traditional market for goods and services oriented toward the top of the pyramid.

The Need for New Goods and Services

The involvement of the private sector at the BOP can provide opportunities for the development of new products and services.

Amul, a dairy cooperative in India, has introduced good quality ice cream at less than $0.05 per serving, affordable by all at the BOP. This product is not only a source of enjoyment; the milk in it is also a source of nutrition for the poor. Now, Amul is planning to introduce a natural laxative-laced ice cream called "isabgol-enriched." It is too early to tell whether the product can be a success. However, the experimentation is what the game is about. Similarly, the popularization of pizza by the same company allows the poor to obtain an adequate quantity of protein.[5] PRODEM FFP, a Bolivian financial services company, has introduced smart automated teller machines (ATMs) that recognize fingerprints, use color-coded touch screens, and speak in three local languages. This technological innovation allows even illiterate BOP consumers to access, on a 24-hour basis, high-quality financial services.[6] Cemex, as we saw earlier, provides access to good quality housing. Through Tecnosol, the BOP consumers in rural Nicaragua have access to clean energy from renewable sources—solar and wind power. Previously, these consumers did not have access to grid-based electricity and were dependent on more expensive sources, such as kerosene and batteries. Now they have energy that is affordable enough to run their households. Casas Bahia not only sells appliances, but has also introduced a line of good quality furniture oriented toward the BOP markets. Furniture has become one of the fastest growing businesses for the company as well as a source of pride and satisfaction to its consumers.

Dignity and Choice

When the poor are converted into consumers, they get more than access to products and services. They acquire the dignity of attention and choices from the private sector that were previously reserved for the middle-class and rich.

The farmers we interviewed at an ITC e-Choupal were very clear. The traditional auctioning system at the government-mandated markets (mandis) did not offer them any choices. Once they went to a mandi, they had to sell their produce at the prices offered on that day. They could not wait for better prices or haul their produce back to their villages. More important, the local merchants who controlled the mandi were not very respectful of the farmers. One farmer remarked, "They make rude comments about my produce. They also raise the prices in the auction by $0.02 per ton. It is as if they have already determined the price you will get and they go through the motions of an auction. It used to be very demeaning." Not any longer. Now, the same farmers can access information on the Web across all the mandis and can decide where, when, and at which prices they want to sell. Similarly, women in self-help groups (SHGs) working with ICICI Bank in India also have had their dignity restored. As a group, they decide which borrowers and projects will receive loans. This involvement of women in leadership development and in learning about finances and bank operations has given them a new sense of personal worth. The single-serve revolution has created a revolutionary level of choice for consumers at the BOP. For example, the "switching costs" for the consumer are negligible because she can buy a sachet of shampoo or detergent or pickles; if she is not satisfied with her purchase she can switch brands the next day. Firms must continuously innovate and upgrade their products to keep customers interested in their brands, thereby improving quality and reducing costs.

Trust Is a Prerequisite

Both sides—the large firms and the BOP consumers—have traditionally not trusted each other. The mistrust runs deep. However, private-sector firms approaching the BOP market must focus on building trust between themselves and the consumers.

This is clearly evident when one visits a Casas Bahia store. BOP consumers here venerate the founder, Mr. Klein, for giving them the opportunity to possess appliances that they could not otherwise afford. Although the shanty towns of Sao Paulo or Rio de Janeiro can be dangerous to outsiders, Casas Bahia trucks move freely around without worry. The same is true for Bimbo, the provider of fresh bread and other bakery products to the BOP consumers in Mexico. Bimbo[7] is the largest bakery in Mexico and its trucks have become symbols of trust between the BOP consumers and the firm. The truck drivers are so trusted that often the small store owners in the slums allow them to open their shops, stock them with bread, and collect cash from the cash boxes without supervision. Both Casas Bahia and Bimbo believe that the truck drivers who deliver their products to the BOP consumers are their ambassadors and neither company will outsource the delivery process. In fact, all managers at Bimbo must work as truck drivers for the company to become better educated about their customers.

MNCs often assume that the default rate among the poor is likely to be higher than that of their rich customers. The opposite is often true. The poor pay on time and default rates are very low. In the case of ICICI Bank, out of a customer base of 200,000, the default rate is less than 1 percent.

The default rate at Grameen Bank, a microfinance pioneer in Bangladesh, is less than 1.5 percent among 2,500,000 customers. The lessons are clear. Through persistent effort and the provision of world-class quality, private-sector businesses can create mutual trust and responsibility between their companies and BOP customers. Trust is difficult to build after 50 years of suspicion and prejudice based on little evidence and strong stereotyping.

BENEFITS TO THE PRIVATE SECTOR

We have identified the immediate benefits of treating the poor as consumers as well as the poverty alleviation process that will result as businesses focus on the BOP. It is clear that the consumers (the poor) benefit, but do the private-sector businesses benefit as well? The BOP market potential is huge: 4 to 5 billion underserved people and an economy of more than $13 trillion PPP. The needs of the poor are many. The case for growth opportunity in the BOP markets is easy to make. However, to participate in these markets, the private sector must learn to innovate. Traditional products, services, and management processes will not work.

Notes

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The Great Non-Debate over International Sweatshops

IAN MAITLAND

In recent years there has been a dramatic growth in the contracting out of production by companies in the industrialized countries to suppliers in developing countries. This globalization of production has led to an emerging international division of labor in footwear and apparel in which companies like Nike and Reebok concentrate on product design and marketing but rely on a network of contractors in Indonesia, China, Central America, etc., to build shoes or sew shirts according to exact specifications and deliver a high quality good according to precise delivery schedules. As Nike's vice president for Asia has put it, "We don't know the first thing about manufacturing. We are marketers and designers."

From Ian Maitland, "The Great Non-Debate Over International Sweatshops," *British Academy of Management Annual Conference Proceedings*, September, 1997, pp. 240–265. Reprinted by permission of the author.

The contracting arrangements have drawn intense fire from critics—usually labor and human rights activists. These "critics" (as I will refer to them) have charged that the companies are (by proxy) exploiting workers in the plants (which I will call "international sweatshops") of their suppliers. Specifically the companies stand accused of chasing cheap labor around the globe, failing to pay their workers living wages, using child labor, turning a blind eye to abuses of human rights, being complicit with repressive regimes in denying workers the right to join unions and failing to enforce minimum labor standards in the workplace, and so on.

The campaign against international sweatshops has largely unfolded on television and, to a lesser extent, in the print media. What seems like no more than a handful of critics has mounted an aggressive, media-savvy campaign which has put the publicity-shy retail giants on the defensive. The critics have orchestrated a series of sensational "disclosures" on prime time television exposing the terrible pay and working conditions in factories making jeans for Levi's or sneakers for Nike or Pocahontas shirts for Disney. One of the principal scourges of the companies has been Charles Kernaghan who runs the National Labor Coalition (NLC), a labor human rights group involving 25 unions. It was Kernaghan who, in 1996, broke the news before a Congressional committee that Kathie Lee Gifford's clothing line was being made by 13- and 14-year-olds working 20 hour days in factories in Honduras. Kernaghan also arranged for teenage workers from sweatshops in Central America to testify before Congressional committees about abusive labor practices. At one of these hearings, one of the workers held up a Liz Claiborne cotton sweater identical to ones she had sewn since she was a 13-year-old working 12 hours a day. According to a news report "[t]his image, accusations of oppressive conditions at the factory and the Claiborne logo played well on that evening's network news." The result has been a circus-like atmosphere—as in Roman circus where Christians were thrown to lions.

Kernaghan has shrewdly targeted the companies carefully cultivated public images. He has explained: "Their image is everything. They live and die by their image. That gives you a certain power over them." As a result, he says, "these companies are sitting ducks. They have no leg to stand on. That's why it's possible for a tiny group like us to take on a giant like Wal-Mart. You can't defend paying someone 31 cents an hour in Honduras. . . ."[1] Apparently most of the companies agree with Kernaghan. Not a single company has tried to mount a serious defense of its contracting practices. They have judged that they cannot win a war of soundbites with the critics. Instead of making a fight of it, the companies have sued for peace in order to protect their principal asset—their image.

Major U.S. retailers have responded by adopting codes of conduct on human and labor rights in their international operations. Levi-Strauss, Nike, Sears, J.C. Penney, Wal-Mart, Home Depot, and Philips Van-Heusen now have such codes. As Lance Compa notes, such codes are the result of a blend of humanitarian and pragmatic impulses: "Often the altruistic motive coincides with the 'bottom line' considerations related to brand name, company image, and other intangibles that make for core value to the firm."[2] Peter Jacobi, President of Global Sourcing for Levi-Strauss has advised: "If your company owns a popular brand, protect this priceless asset at all costs. Highly visible companies have any number of reasons to conduct their business not just responsibly but also in ways that cannot be portrayed as unfair, illegal, or unethical. This sets an extremely high standard since it must be applied to both company owned businesses and contractors. . . ."[3] And according to another Levi-Strauss spokesman, "In many respects, we're protecting our single largest asset: our brand image and corporate reputation."[4] Nike recently published the results of a generally favorable review of its international operations conducted by former American Ambassador Andrew Young.

Recently, a truce of sorts between the critics and the companies was announced on the White House lawn with President Clinton and Kathie Lee Gifford in attendance. A presidential task force, including representatives of labor unions, human rights groups and apparel companies like L.L. Bean and Nike, has come up with a set of voluntary standards which, it hopes, will be embraced by the entire industry. Companies that comply with the code will be entitled to use a "No Sweat" label.

OBJECTIVES OF THIS PAPER

In this confrontation between the companies and their critics, neither side seems to have judged it to be in its interest to seriously engage the issue at the heart of this controversy, namely: What are appropriate wages and labor standards in international sweatshops? As we have seen, the companies have treated the charges about sweatshops as a public relations problem to be managed so as to minimize harm to their public images. The critics have apparently judged that the best way to keep public indignation at the boiling point is to oversimplify the issue and treat it as a morality play featuring heartless exploiters and victimized third world workers. The result has been a great non-debate over international sweatshops. Paradoxically, if peace breaks out between the two sides, the chances that the debate will be seriously joined may recede still further. Indeed, there exists a real risk (I argue) that any such truce may be a collusive one that will come at the expense of the very third world workers it is supposed to help.

This paper takes up the issue of what are appropriate wages and labor standards in international sweatshops. Critics charge that the present arrangements are exploitative. I proceed by examining the specific charges of exploitation from the standpoints of both (a) their factual and (b) their ethical sufficiency. However, in the absence of any well-established consensus among business ethicists (or other thoughtful observers), I simultaneously use the investigation of sweatshops as a setting for trying to adjudicate between competing views about what those standards should be. My examination will pay particular attention to (but will not be limited to) labor conditions at the plants of Nike's suppliers in Indonesia. I have not personally visited any international sweatshops, and so my conclusions are based entirely on secondary analysis of the voluminous published record on the topic.

WHAT ARE ETHICALLY APPROPRIATE LABOR STANDARDS IN INTERNATIONAL SWEATSHOPS?

What are ethically acceptable or appropriate levels of wages and labor standards in international sweatshops? The following three possibilities just about run the gamut of standards or principles that have been seriously proposed to regulate such policies.

1. *Home-country standards:* It might be argued (and in rare case has been) that international corporations have an ethical duty to pay the same wages and provide the same labor standards regardless of where they operate. However, the view that home-country standards should apply in host-countries is rejected by most business ethicists and (officially at least) by the critics of international sweatshops. Thus, Thomas Donaldson argues that "[by] arbitrarily establishing U.S. wage levels as the benchmark for fairness one eliminates the role of the international market in establishing salary levels, and this in turn eliminates the incentive U.S. corporations have to hire foreign workers."[5] Richard De George makes much the same argument: If there were a rule that said that "that American MNCs [multinational corporations] that wish to be ethical must pay the same wages abroad as they do at home, . . . [then] MNCs would have little incentive to move their manufacturing abroad; and if they did move abroad they would disrupt the local labor market with artificially high wages that bore no relation to the local standard or cost of living."[6]
2. *"Living wage" standard:* It has been proposed that an international corporation should, at a minimum, pay a "living wage." Thus De George says that corporations should pay a living wage "even when this is not paid by local firms."[7] However, it is hard to pin down what this means operationally. According to De George, a living wage should "allow the worker to live in dignity as a human being." In order to respect the human rights of its workers, he says, a corporation must pay "at least subsistence wages and as much above that as workers and their dependents need to live with reasonable dignity, given the general state of development of the society."[8] As we shall see, the living wage standard has become a rallying cry of the critics of international sweatshops. Apparently, De George believes that it is preferable for a corporation to provide no job at all than to offer one that pays less than a living wage. . . .
3. *Classical liberal standard:* Finally, there is what I will call the classical liberal standard. According to this standard a practice (wage or labor practice) is ethically acceptable if it is freely chosen by informed workers. For example, in a recent report the World Bank invoked this standard in connection with workplace safety. It said: "The appropriate level is therefore that at which the costs are commensurate with the value that informed workers place on improved working conditions and reduced risk."[9] Most business ethicists reject this standard on the grounds that there is some sort of market failure or the "background conditions" are lacking for markets to work effectively. Thus for Donaldson full (or near-full) employment is a prerequisite if workers are to make sound choices regarding workplace safety:

> The average level of unemployment in the developing countries today exceeds 40 percent, a figure that has frustrated the application of neoclassical economic principles to the international economy on a score of issues. With full employment, and all other things being equal, market forces will encourage workers to make trade-offs between job opportunities using safety as a variable. But with massive unemployment, market forces in developing countries drive the unemployed to the jobs they are lucky enough to land, regardless of the safety.[10]

Apparently there are other forces, like Islamic fundamentalism and the global debt "bomb" that rule out reliance on market solutions, but Donaldson does not explain their relevance.[11] De George, too, believes that the necessary conditions are lacking for market forces to operate benignly. Without what he calls "background institutions" to protect the workers and the resources of the developing country (e.g., enforceable minimum wages) and/or greater equality of bargaining power exploitation is the most likely result.[12] "If American MNCs pay workers very low wages . . . they clearly have the opportunity to make significant profits."[13] De George goes on to make the interesting observation that "competition has developed among multinationals themselves, so that the profit margin has been driven down" and developing countries "can play one company against another."[14] But apparently that is not enough to rehabilitate market forces in his eyes.

THE CASE AGAINST INTERNATIONAL SWEATSHOPS

To many of their critics, international sweatshops exemplify the way in which the greater openness of the world economy is hurting workers. . . . Globalization means a transition from (more or less) regulated domestic economies to an unregulated world economy. The superior mobility of capital, and the essentially fixed, immobile nature of world labor, means a fundamental shift in bargaining power in favor of large international corporations. Their global reach permits them to shift production almost costlessly from one location to another. As a consequence, instead of being able to exercise some degree of control over companies operating within their borders, governments are now locked in a bidding war with one another to attract and retain the business of large multinational companies.

The critics allege that international companies are using the threat of withdrawal or withholding investment to pressure and workers to grant concessions. "Today [multinational companies] choose between workers in developing countries that compete against each other to depress wages to attract foreign investment." The result is a race for the bottom—a "destructive downward bidding spiral of the labor conditions and wages of workers throughout the world. . . ."[15] Thus critics charge that in Indonesia wages are deliberately held below the poverty level or subsistence in order to make the country a desirable location. The results of this competitive dismantling of worker protections, living standards, and worker rights are predictable: deteriorating work conditions, declining real incomes for workers, and a widening gap between rich and poor in developing countries. I turn next to the specific charges made by the critics of international sweatshops.

Unconscionable Wages

Critics charge that the companies, by their proxies, are paying "starvation wages" and "slave wages." They are far from clear about what wage level they consider to be appropriate. But they generally demand that companies pay a "living wage." Kernaghan has said that workers should be paid enough to support their families and they should get a "living wage" and "be treated like human beings."[16] . . . According to Tim Smith, wage levels should be "fair, decent or a living wage for an employee and his or her family." He has said that wages in the maquiladoras of Mexico averaged $35 to $55 a week (in or near 1993) which he calls a "shockingly substandard wage," apparently on the grounds that it "clearly does not allow an employee to feed and care for a family adequately."[17] In 1992, Nike came in for harsh criticism when a magazine published the pay stub of a worker at one of its Indonesian suppliers. It showed that the worker was paid at the rate of $1.03 per day which was reportedly less than the Indonesian government's figure for "minimum physical need."[18]

Immiserization Thesis

Former Labor Secretary Robert Reich has proposed as a test of the fairness of development policies that "Low-wage workers should become better off, not worse off, as trade and investment boost national income." He has written that "[i]f a country pursues policies that . . . limit to a narrow elite the benefits of trade, the promise of open commerce is perverted and drained of its rationale."[19] A key claim of the activists is that companies actually impoverish or immiserize developing country workers. They experience an absolute decline in living standards. This thesis follows from the claim that the bidding war among developing countries is depressing wages. . . .

Widening Gap Between Rich and Poor

A related charge is that international sweatshops are contributing to the increasing gap between rich and poor. Not only are the poor being absolutely impoverished, but trade in generating greater inequality within developing countries. Another test that Reich has proposed to establish the fairness of international trade is that "the gap between rich and poor should tend to narrow with development, not widen."[20] Critics charge that international sweatshops flunk that test. They say that the increasing GNPs of some developing countries simply mask a widening gap between rich and poor. "Across the world, both local and foreign elites are getting richer from the exploitation of the most vulnerable."[21] And, "The major adverse consequence of quickening global economic integration has been widening income disparity within almost all nations. . . ."[22] There appears to be a tacit alliance between the elites of both first and third worlds to exploit the most vulnerable, to regiment and control and conscript them so that they can create the material conditions for the elites' extravagant lifestyles.

Collusion with Repressive Regimes

Critics charge that, in their zeal to make their countries safe for foreign investment, Third World regimes, notably China and Indonesia, have stepped up their repression. Not only have these countries failed to enforce even the minimal labor rules on the books, but they have also used their military and police to break strikes and suppress independent unions. They have stifled political dissent, both to retain their hold on political power and to avoid any instability that might scare off foreign investors. Consequently, critics charge, companies like Nike are profiting from political repression. "As unions spread in [Korea and Taiwan], Nike shifted its suppliers primarily to Indonesia, China and Thailand, where they could depend on governments to suppress independent union-organizing efforts."[23]

EVALUATION OF THE CHARGES AGAINS INTERNATIONAL SWEATSHOPS

The critics' charges are undoubtedly accurate on a number of points: (1) There is no doubt that international companies are chasing cheap labor. (2) The wages paid by the international sweatshops are—by American standards—shockingly low. (3) Some developing country governments have tightly controlled or repressed organized labor in order to prevent it from disturbing the flow of foreign investment. Thus, in Indonesia, independent unions have been suppressed. (4) It is not unusual in developing countries for minimum wage levels to be lower than the official poverty level. (5) Developing country governments have winked at violations of minimum wage laws and labor rules. However, most jobs are in the informal sector and so largely outside the scope of government supervision. (6) Some suppliers have employed children or have subcontracted work to other producers who have done so. (7) Some developing country governments deny their people basic political rights. China is the obvious example; Indonesia's record is pretty horrible but had shown steady improvement until the last two years. But on many of the other counts, the critics charges appear to be seriously inaccurate. And, even where the charges are accurate, it is not self-evident that the practices in question are improper or unethical, as we see next.

Wages and Conditions

Even the critics of international sweatshops do not dispute that the wages they pay are generally higher than—or at least equal to—comparable wages in the labor markets where they operate. According to the International Labor Organization (ILO), multinational companies often apply standards relating to wages, benefits, conditions of work, and occupational safety and health, which both exceed statutory requirements and those practiced by local firms.[24] The ILO also says that wages and working conditions in so-called Export Processing Zones (EPZs) are often equal to or higher than jobs outside. The World Bank says that the poorest workers in developing countries work in the informal sector where they often earn less than half what a formal sector employee earns. Moreover, "informal and rural workers often must work under more hazardous and insecure conditions than their formal sector counterparts."[25]

The same appears to hold true for the international sweatshops. In 1996, young women working in the plant of a Nike supplier in Serang, Indonesia were earning the Indonesian legal minimum wage of 5,200 rupiahs or about $2.28 each day. As a report in the *Washington Post* pointed out, just earning the minimum wage put these workers among higher-paid Indonesians: "In Indonesia, less than half the working population earns the minimum wage, since about half of all adults here are in farming, and the typical farmer would make only about 2,000 rupiahs each day."[26] The workers in the Serang plant reported that they save about three-quarters of their pay.

A 17-year-old woman said: "I came here one year ago from central Java. I'm making more money than my father makes." This woman also said that she sent about 75 percent of her earnings back to her family on the farm.[27] Also in 1996, a Nike spokeswoman estimated that an entry-level factory worker in the plant of a Nike supplier made five times what a farmer makes.[28] Nike's chairman, Phil Knight, likes to teasingly remind critics that the average worker in one of Nike's Chinese factories is paid more than a professor at Beijing University.[29] There is also plentiful anecdotal evidence from non-Nike sources. A worker at the Taiwanese-owned King Star Garment Assembly plant in Honduras told a reporter that he was earning seven times what he earned in the countryside.[30] In Bangladesh, the country's fledgling garment industry was paying women who had never worked before between $40 and $55 a month in 1991. That compared with a national per capita income of about $200 and the approximately $1 a day earned by many of these women's husbands as day laborers or rickshaw drivers.[31]

The same news reports also shed some light on the working conditions in sweatshops. According to the *Washington Post*, in 1994 the Indonesian office of the international accounting firm Ernst & Young surveyed Nike workers concerning worker pay, safety conditions and attitudes toward the job. The auditors pulled workers off the assembly line at random and asked them questions that the workers answered anonymously. The survey of 25 workers at Nike's Serang plant found that 23 thought the hours and overtime hours too high. None of the workers reported[32] that they had been discriminated against. Thirteen said the working environment was the key reason they worked at the Serang plant while eight cited salary and benefits. The *Post* report also noted that the Serang plant closes for about ten days each year for Muslim holidays. It quoted Nike officials and the plant's Taiwanese owners as saying that 94 percent of the workers had returned to the plant following the recent break....

There is also the mute testimony of the lines of job applicants outside the sweatshops in Guatemala and Honduras. According to Lucy Martinez-Mont, in Guatemala the sweatshops are conspicuous for the long lines of young people waiting to be interviewed for a job.[33] Outside the gates of the industrial park in Honduras that Rohter visited "anxious on-lookers are always waiting, hoping for a chance to at least fill out a job application for [employment at one of the apparel plants].[34]

The critics of sweatshops acknowledge that workers have voluntarily taken their jobs, consider themselves lucky to have them, and want to keep them.... But they go on to discount the workers' views as the product of confusion or ignorance, and/or they just argue that the workers' views are beside the point. Thus, while "it is undoubtedly true" that Nike has given jobs to thousands of people who wouldn't be working otherwise, they say that "neatly skirts the fundamental human-rights issue raised by these production arrangements that are now spreading all across the world."[35] Similarly the NLC's Kernaghan says that "[w]hether workers think they are better off in the assembly plants than elsewhere is not the real issue."[36] Kernaghan, and Jeff Ballinger of the AFL-CIO, concede that the workers desperately need these jobs. But "[t]hey say they're not asking that U.S. companies stop operating in these countries. They're asking that workers be paid a living wage and treated like human beings."[37] Apparently these workers are victims of what Marx called false consciousness, or else they would grasp that they are being exploited. According to Barnet and Cavanagh, "For many workers . . . exploitation is not a concept easily comprehended because the alternative prospects for earning a living are so bleak."[38]

Immiserization and Inequality

The critics' claim that the countries that host international sweatshops are marked by growing poverty and inequality is flatly contradicted by the record. In fact, many of those countries have experienced sharp increases in living standards—for all strata of society. In trying to attract investment in simple manufacturing, Malaysia and Indonesia and, now, Vietnam and China, are retracing the industrialization path already successfully taken by East Asian countries like Taiwan, Korea, Singapore and Hong Kong. These four countries got their start by producing labor-intensive manufactured goods (often electrical and electronic components, shoes, and garments) for export markets. Over time they graduated to the export of higher value-added items that are skill-intensive and require a relatively developed industrial base.[39]

As is well known, these East Asian countries achieved growth rates exceeding eight percent for a quarter century. . . . The workers in these economies achieved essentially full employment in the 1960s. Real wages rose by as much as a factor of four. Absolute poverty fell. And income inequality remained at low to moderate levels. It is true that in the initial stages the rapid growth generated only moderate increases in wages. But once essentially full employment was reached, and what economists call the Fei-Ranis turning point was reached, the increased demand for labor resulted in the bidding up of wage as firms competed for a scarce labor supply.

Interestingly, given its historic mission as a watchdog for international labor standards, the ILO had embraced this development model. It recently noted that the most successful developing economies, in terms of output and employment growth, have been "those who best exploited emerging opportunities in the global economy."[40] An "export oriented policy is vital in countries that are starting on the industrialization path and have large surpluses of cheap labor." Countries which have succeeded in attracting foreign direct investment (FDI) have experienced rapid growth in manufacturing output and exports. The successful attraction of foreign investment in plant and equipment "can be a powerful spur to rapid industrialization and employment creation." "At low levels of industrialization, FDI in garments and shoes and some types of consumer electronics can be very useful for creating employment and opening the economy to international markets; there may be some entrepreneurial skills created in simple activities like garments (as has happened in Bangladesh). Moreover, in some cases, such as Malaysia, the investors may strike deeper roots and invest in more capital-intensive technologies as wages rise."

According to the World Bank, the rapidly growing Asian economies (including Indonesia) "have also been unusually successful at sharing the fruits of their growth."[41] In fact, while inequality in the West has been growing, it has been shrinking in the Asian economies. They are the only economies in the world to have experienced high growth *and* declining inequality, and they also show shrinking gender gaps in education. . . .

Profiting from Repression?

What about the charge that international sweatshops are profiting from repression? It is undeniable that there is repression in many of the countries where sweatshops are located. But economic development appears to be relaxing that repression rather than strengthening its grip. The companies are supposed to benefit from government policies (e.g., repression of unions) that hold down labor costs. However, as we have seen, the wages paid by the international sweatshops already match or exceed the prevailing local wages. Not only that, but incomes in the East Asian economies, and in Indonesia, have risen rapidly. . . .

The critics, however, are right in saying that the Indonesian government has opposed independent unions in the sweatshops out of fear they would lead to higher wages and labor unrest. But the government's fear clearly is that unions might drive wages in the modern industrial sector *above* market-clearing levels—or, more exactly, further above market. It is ironic that critics like Barnet and Cavanagh would use the Marxian term "reserve army of the unemployed." According to Marx, capitalists deliberately maintain high levels of unemployment in order to control the working class. But the Indonesian government's policies (e.g., suppression of unions, resistance to a higher minimum wage and lax enforcement of labor rules) have been directed at achieving exactly the opposite result. The government appears to have calculated that high unemployment is a greater threat to its hold on power. I think we can safely take at face value its claims that its policies are genuinely intended to help the economy create jobs to absorb the massive numbers of unemployed and underemployed.[42]

LABOR STANDARDS IN INTERNATIONAL SWEATSHOPS: PAINFUL TRADE-OFFS

Who but the grinch could begrudge paying a few additional pennies to some of the world's poorest workers? There is no doubt that the rhetorical force of the critics' case against international sweatshops rests on this apparently self-evident proposition. However, higher wages and improved labor standards are not free. After all, the critics themselves attack companies for chasing cheap labor. It follows that, if labor in developing countries is made more expensive (say, as the result of pressure by the critics), then those countries will receive less foreign investment, and fewer jobs will be created there. Imposing higher wages may deprive those countries of the one comparative advantage they enjoy, namely low-cost labor.

We have seen that workers in most "international sweatshops" are already relatively well paid. Workers in the urban, formal sectors of developing countries commonly earn more than twice what informal and rural workers get. Simply earning the minimum wage put the young women making Nike shoes in Serang in the top half of the income distribution in Indonesia. Accordingly, the critics are in effect calling for a *widening* of the economic disparity that already greatly favors sweatshop workers.

By itself that may or may not be ethically objectionable. But these higher wages come at the expense of the incomes and the job opportunities of much poorer workers. As economists explain, higher wages in the formal sector reduce employment there and (by increasing the supply of labor) depress incomes in the informal sector. The case against requiring above-market wages for international sweatshop workers is essentially the same as the case against other measures that artificially raise labor costs, like the minimum wage. In Jagdish Bhagwati's words, "Requiring a minimum wage in an overpopulated, developing country may actually be morally wicked. A minimum wage might help the unionized, industrial proletariat, while limiting the ability to save and invest rapidly which is necessary to draw more of the unemployed and nonunionized rural poor into gainful employment and income."[43] The World Bank makes the same point: "Minimum wages may help the most poverty-stricken workers in industrial countries, but they clearly do not in developing nations. . . . The workers whom minimum wage legislation tries to protect—urban formal workers—already earn much more than the less favored majority. . . . And inasmuch as minimum wage and other regulations discourage formal employment by increasing wage and nonwage costs, they hurt the poor who aspire to formal employment."[44]

The story is no different when it comes to labor standard other than wages. If standards are set too high they will hurt investment and employment. The World Bank report points out that "[r]educing hazards in the workplace is costly, and typically the greater the reduction the more it costs. Moreover, the costs of compliance often fall largely on employees through lower wages or reduced employment. As a result, setting standards too high can actually lower workers' welfare. . . ."[45] Perversely, if the higher standards advocated by critics retard the growth of formal sector jobs, then that will trap more informal and rural workers in jobs which are far more hazardous and insecure than those of their formal sector counterparts.

The critics consistently advocate policies that will benefit better-off workers at the expense of worse-off ones. If it were within their power, it appears that they could reinvent the labor markets of much of Latin America. Alejandro Portes' description seems to be on the mark: "In Mexico, Brazil, Peru, and other Third World countries, [unlike East Asia], there are powerful independent unions representing the protected sector of the working class. Although their rhetoric is populist and even radical, the fact is that they tend to represent the better-paid and more stable fraction of the working class. Alongside, there toils a vast, unprotected proletariat, employed by informal enterprises and linked, in ways hidden from public view, with modern sector firms." . . .

Of course, it might be objected that trading off workers' rights for more jobs is unethical. But, so far as I can determine, the critics have not made this argument. Although they sometimes implicitly accept the existence of the trade-off (we saw that they attack Nike for chasing cheap labor), their public statements are silent on the lost or foregone jobs from higher wages and better labor standards. At other times, they imply or claim that improvements in workers' wages and conditions are essentially free. . . .

In summary, the result of the ostensibly humanitarian changes urged by critics are likely to be (1) reduced employment in the formal or modern sector of the economy, (2) lower incomes in the informal sector, (3) less investment and so slower economic growth, (4) reduced exports, (5) greater inequality and poverty.

CONCLUSION: THE CASE FOR NOT EXCEEDING MARKET STANDARDS

It is part of the job description of business ethicists to exhort companies to treat their workers better (otherwise what purpose do they serve?). So it will have come as no surprise that both the business ethicists whose views I summarized at the beginning of the paper—Thomas Donaldson and Richard De George—objected to letting the market alone determine wages and labor standards in multinational companies. Both of them proposed criteria for setting wages that might occasionally "improve" on the outcomes of the market.

Their reasons for rejecting market determination of wages were similar. They both cited conditions that allegedly prevent international markets from generating ethically acceptable results. Donaldson argued that neoclassical economic principles are not applicable to international business because of high unemployment rates in developing countries. And De George argued that, in an unregulated international market, the gross inequality of bargaining power between workers and companies would lead to exploitation.

But this paper has shown that attempts to improve on market outcomes may have unforeseen tragic consequences. We saw how raising the wages of workers in international sweatshops might wind up penalizing the most vulnerable workers (those in the informal sectors of developing countries) by depressing their wages and reducing their job opportunities in the formal sector. Donaldson and De George cited high unemployment and unequal bargaining power as conditions that made it necessary to bypass or override the market determination of wages. However, in both cases, bypassing the market in order to prevent exploitation may aggravate these conditions. As we have seen, above-market wages paid to sweatshop workers may discourage further investment and so perpetuate high unemployment. In turn, the higher unemployment may weaken the bargaining power of workers vis-à-vis employers. Thus such market imperfections seem to call for more reliance on market forces rather than less. Likewise, the experience of the newly industrialized East Asian economies suggests that the best cure for the ills of sweatshops is more sweatshops. But most of the well-intentioned policies that improve on market outcomes are likely to have the opposite effects.

Where does this leave the international manager? If the preceding analysis is correct, then it follows that it is ethically permissible to pay market wage rates in developing countries (and to provide employment conditions appropriate for the level of development). That holds true even if the wages pay less than so-called living wages or subsistence or even (conceivably) the local minimum wage. The appropriate test is not whether the wage reaches some predetermined standard, but whether it is freely accepted by (reasonably) informed workers. The workers themselves are in the best position to judge whether the wages offered are superior to their next best alternatives. (The same logic applies *mutatis mutandis* to workplace labor standards.)

Indeed, not only is it ethically acceptable for a company to pay market wages, but it may be ethically unacceptable for it to pay wages that exceed market levels. That will be the case if the company's above-market wages set precedents for other international companies which raise labor costs to the point of discouraging foreign investment. Furthermore, companies may have a social responsibility to transcend their own narrow preoccupation with protecting their brand image and to publicly defend a system which has greatly improved the lot of millions of workers in developing countries.

Notes

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2. Lance A. Compa and Tashia Hinchliffe Darricarrere, "Enforcement Through Corporate Codes of Conduct," in Compa and Stephen F. Diamond, *Human Rights, Labor Rights, and International Trade* (Philadelphia: University of Pennsylvania Press, 1996) p. 193.
3. Peter Jacobi, in Martha Nichols, "Third-World Families at Work: Child Labor or Child Care." *The Harvard Business Review* (January-February, 1993).
4. David Sampson, in Robin G. Givhan, "A Stain on Fashion; The Garment Industry Profits from Cheap Labor." *Washington Post* (September 12, 1995), p. B1.
5. Thomas Donaldson, *Ethics of International Business* (New York: Oxford University Press, 1989), p. 98.
6. Richard De George, *Competing with Integrity in International Business* (New York: Oxford University Press, 1993), p. 79.
7. Ibid., pp. 356–357.
8. Ibid., p. 78.
9. World Bank, *World Development Report 1995, "Workers in an Integrating World Economy"* (Oxford University Press, 1995), p. 77.
10. Donaldson, op. cit., p. 115.
11. Ibid., p. 150.
12. De George, op. cit., p. 48.
13. Ibid., p. 358.
14. Ibid.
15. Terry Collingsworth, J. William Goold, Pharis J. Harvey, "Time for a Global New Deal," *Foreign Affairs* (January-February 1994), p.8.
16. William B. Falk, "Dirty Little Secrets," *Newsday* (June 16, 1996).
17. Tim Smith, "The Power of Business for Human Rights," *Business & Society Review* (January, 1994), p. 36.
18. Jeffrey Ballinger, "The New Free Trade Heel," *Harper's Magazine* (August 1992), pp. 46–47. As in many developing countries, Indonesia's minimum wage, . . . is less than poverty level." Nina Baker, "The Hidden Hands of Nike," *Oregonian* (August 9, 1992).
19. Robert B. Reich, "Escape from the Global Sweatshop. Capitalism's Stake in Uniting the Workers of the World," *Washington Post* (May 22, 1994). Reich's test is intended to apply in developing countries "where democratic institutions are weak or absent."
20. Ibid.
21. Kenneth P. Hutchinson, "Third World Growth," *Harvard Business Review* (November-December 1994).
22. Robin Broad and John Cavanagh, "Don't Neglect the Impoverished South," *Foreign Affairs* (December 22, 1995).
23. John Cavanagh and Robin Broad, "Global Reach: Workers Fight the Multinationals," *The Nation* (March 18, 1996), p. 21. See also Bob Herbert, "Nike's Bad Neighborhood," *New York Times* (June 14, 1996).
24. International Labor Organization, *World Employment 1995* (Geneva: ILO, 1995), p. 73.
25. World Bank, op. cit., p. 5.
26. Keith B. Richburg and Anne Swarsdon, "U.S. Industry Overseas: Sweatshop or Job Source?: Indonesians Praise Work at Nike Factory," *Washington Post* (July 28, 1996).
27. Richburg and Swarsdon, op. cit. The 17-year-old was interviewed in the presence of managers. For other reports that workers remit home large parts of their earnings see Seth Mydans, "Tangerang Journal; For Indonesian Workers at Nike Plant: Just Do It," *New York Times* (August 9, 1996), and Nina Baker, op. cit.
28. Donna Gibbs, Nike spokeswoman on ABC's *World News Tonight*, June 6, 1996.
29. Mark Clifford, "Trading in Social Issues: Labor Policy and International Trade Regulations," *World Press Review* (June 1994), p. 36.
30. Larry Rohter, "To U.S. Critics, a Sweatshop; for Hondurans, a Better Life," *New York Times* (July 18, 1996).
31. Marcus Brauchli, "Garment Industry Booms in Bangladesh," *Wall Street Journal* (August 6, 1991).
32. Richburg and Swarsdon, op. cit.
33. Lucy Martinez-Mont, "Sweatshops Are Better Than No Shops," *Wall Street Journal* (June 25, 1996).
34. Rohter, op. cit.
35. Richard Barnet and Cavanagh, 1995. *Global Dreams*, N.Y. Simon and Schuster.
36. Rohter, op. cit.
37. William B. Falk, "Dirty Little Secrets," *Newsday* (June 16, 1996).
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39. Saroh Kuruvilla, "Linkages Between Industrialization Strategies and Industrial Relations/Human Resources Policies: Singapore, Malaysia, The Philippines, and India," *Industrial & Labor Relations Review* (July 1996), p. 637.
40. The ILO's Constitution (of 1919) mentions that ". . . the failure of any nation to adopt humane conditions of labor is an obstacle in the way of other nations which desire to improve the conditions in their own countries." ILO, *World Employment 1995*, p. 74.
41. World Bank, *The East Asian Miracle* (New York: Oxford University Press, 1993), p. 2.
42. Gideon Rachman, "Wealth in Its Grasp, a Survey of Indonesia, " *Economist* (April 17, 1993), pp. 14–15.
43. Jagdish Bhagwati and Robert E. Hudec, eds., *Fair Trade and Harmonization* (Cambridge, MA: MIT Press, 1996), vol. 1, p. 2.
44. World Bank, *Workers in an Integrating World Economy*, p. 75.
45. Ibid., p. 77. As I have noted, the report proposes that the "appropriate level is therefore that at which the costs are commensurate with the value that informed workers place on improved working conditions and reduced risk . . ." (p. 77).