Lecture 5

The Benefits and Costs of Certification to Voluntary Sustainability Standards

In this last lecture you will discover the main potential advantages and disadvantages linked to certification.

We will analyze the benefits and costs of certification, considering four dimensions: financial, management, quality, and sustainability.



Benefits and costs of certification

Many national or international business transactions require compliance with mandatory regulations. Compliacen with additional sustainability or quality-oriented standards, and therefore additional certification ,amy not be required. Business "as usual" can continue

Increasingly, however, voluntary sustainability standards may be required in order to complete business transactions with certain buyers. This may apply to both domestic and international transactions. In the latter case, companies that are "export-ready" most often engage in additional certifications.

Reviewing the benefits and costs

One of the ways to better understanding the implications and potential impacts of engaging in VSS certification is to review the "benefits" and "costs" of the process .This can be done by examining them along the following four categories:

	BENEFITS Potential advantages and positive impacts	**COSTS** Potential disadvantages and negative impacts
Financial	Premium, access to financing	Certification, audit and investment costs
Management	Business and market opportunities	Certification, audit and investment costs
Quality	Better quality, productivity and processes	Compliance with requirements difficult in certain contexts
Sustainability	Positive worker/community / environment effects	Limited worker/community / environment effects

Financial benefits – Premiums, access to financing

One of the major benefit of certification for companies are financial gains. These can take the form of:

- **Higher profitability: premium prices for certified products**
  Products and/or services that are certified may be sold for higher prices and thus generate higher profits and net income for certified producers. Such products are often more expensive due to the higher effort which has gone into producing and processing them in a sustainable way. Higher profitability is also directly connected with the increased yields and higher quality of certified produce.
- **Enhanced access to credit**
  As compliance to voluntary standards requires good organizational and management skills, businesses whose products or services are certified increase their credibility vis-à-vis investors, thus enjoying better access to credit. In addition, depending on the voluntary standard, some producers may receive technical and financial support from the standard organization to assist them in implementing the standard requirements and ensure full compliance.

Financial costs – certification, audit and investment costs

The potential financial benefits of certification need to be weighed against the actual monetary costs connected to VSS adoption, such as:

- Certification and consultation fees
- Inspection or audit costs
- Investments needed to meet the compliance requirements
- Additional labour costs

Financial impact – evidence on the ground

Research conducted by ITC on the impact of VSS adoption with regards to business opportunities and producer profitability found that VSS compliance brought predominantly positive financial effects.

At the same time, the results of the survey also pointed out that:

- Increased earning do not necessarily compensate for the additional costs entailed in VSS compliance
- Premiums are not necessarily distributed equally among the actors in the chain

Management benefits – Business and market opportunities

VSS certification has the potential to open new markets, strengthen business relationships and enable businesses to reposition themselves in global markets. The management benefits associated with certification include:

- **Access to new and growing markets, moving beyond "niche" categories**: In the past several years, several sectors of VSS-certified markets have displayed double-digit growth rates, often surpassing the growth rates of conventional markets. VSS-certified products are moving from being niche products to being the mainstream. Growing portions of various global commodity markets are now produced as VSS-certified, creating potential disadvantages for those companies that do not yet have any certification.
- **New clients, or improved relationships with existing clients**: More and more buyers follow the path of "sustainable sourcing", including high-value/high-volume buyers in both the public and the private sector:
    - Public sector: new sustainable public procurement policies. EXAMPLE: The European Commission's "green public procurement" (GPP) strategy. Between 2009 and 2010, 38% of the total value procured by the EU (EU, national, regional or local level). included a GPP criterion.
    - Private sector: global corporations' sustainability commitments are gaining in strength. EXAMPLE: Unilever has pledged that 100% of its agricultural materials will be sustainably sourced by 2020.
- **Repositioning in global value chains**: Compliance with voluntary sustainability standards can translate into gaining the status of preferred supplier, thus giving companies access to a greater market and income security.

Management costs - Uncertainty linked to initial investments

Despite the possible benefits, one of the biggest pitfalls of certification is linked to the potentially uncertain returns which stem from it. The management costs associated with certification include:

- **Obtaining VSS certification does not guarantee that a market will be found for the product**
  If a company cannot find a buyer for its certified products, it will have to sell them on the conventional market, without benefiting from the price premium normally associated with certification.
  The oversupply of some certified products is also a persistent phenomenon in certified markets (in which sales represent a smaller portion of global markets than production). As a result, it is often only part of standard-compliant production which is sold as such.
  EXAMPLE: in 2012, only 44% of standard-compliant commodities were sold as such
- **Most voluntary standards offer only modest premiums for certified products**
  The premiums or (minimum prices) for certified products are not always guaranteed, can potentially be quite small, and vary across different VSS.
  EXAMPLE: Over the past several years, premiums for standard-compliant cocoa have ranged from around 5% for UTZcertified cocoa to 18% or more for organic cocoa

Management impact

According to research done by ITC, the improvements in buyer-seller relationships that result from VSS adoption can be more beneficial for businesses than the immediate monetary benefits.

Quality Management benefits - Better quality, productivity and processes

VSS certification requirements are often targeted towards improving management and production skills which, in turn, improve the efficiency and productivity of businesses. The quality management benefits associated with certification include:

- **Better quality and greater yields**: The business process improvements usually required as part of complying with VSS often result in higher quality products and higher production yields.
- **Better management and production skills**: Certified producers often gain comparably better management and production skills as a result of the upgrading process involved in adopting a VSS, including through taking part in training, implementing continuous improvement requirements, etc.
- **Improved efficiency and productivity**: Adopting better practices and investing in new equipment often contributes to greater efficiency and productivity, especially for farmers or producers who face resource constraints. This potentially results in higher yields/production with the same amount of inputs. As a result, competitiveness improves.

Quality Management costs - Certification, audit and investment costs

The "better practice" adjustments involved in the process of adopting a VSS often affect everyday business practices, separate from the VSS's particular focus on specific production process or product specifications. The quality management costs associated with certification include:

- **Large number of standards**: As the number of available VSS increases, increasing numbers of buyers may require compliance with various VSS. This results in both confusion, as well as in greater transaction costs for producers. In addition, some standards may lack transparency with regards to their certification criteria and procedures.
- **Management time: dealing with difficult requirements**: Becoming certified in a VSS entails additional time required for producers and managers to effectively implement new mechanisms and concepts. While some VSS may impose maximum working hours for employees, buyers do not necessarily relax their delivery requirements. Coping with such conflicting priorities requires managers to develop additional skills
- **Additional organizational units**: In order to implement better business practices, companies often need to set up management and monitoring systems as well as record keeping mechanisms, including (basic) traceability systems , which might require whole new organizational units.
- **Potentially difficult software and hardware improvements**: Some businesses, especially smallholder farmers located in remote areas, may find it difficult to obtain the infrastructure necessary to upgrade their production facilities. This infrastructure can be divided into two types:
    - "hardware": production equipment, information technology and communication systems, warehouses, sanitation infrastructure, etc.
    - "software": implementing rigorous health and safety measures, deliver staff training, etc.

Sustainability benefits - Positive Worker/Community / Environmental effects

The benefits which result from certification in a VSS can positively impact the working environment of a company, the well-being of its community, as well as help protect the environment. The sustainability benefits associated with certification include:

- **Better working environment: Improved employee welfare and motivation (lower absenteeism, lower number of work-related accidents):** Improvement of basic working conditions for employees, including job security, medical and hospital treatment. Increase in the use of labor contracts, safety equipment, the availability of first-aid kits. Higher satisfaction of workers due to higher technical assistance and lower trade risk.
- **Developments in the community and livelihoods of producers**: Some voluntary standards aim to extend their impact beyond individual producers, generating positive change at the local community level. Higher incomes associated with producer certification may also improve the overall living conditions of producers.
- **Environmental protection**: VSS can fill a gap in addressing issues which are not, or cannot, be tackled by public regulation, or where such regulation is insufficient. Typical

example includes the conservation of forests. VSS often include specific requirements, often associated with production processes or methods, which aim to substantially improve environmental management practices.

Sustainability costs - Limited Worker/Community/Environment effects

While the overarching goal of VSS is to address wider sustainability issues, the benefits associated with compliance do not always necessarily translate into a wide positive impact.

- **The additional resources created through better practices are not used towards community development**: The increased net income of VSS-compliant producers is not necessarily used to improve the livelihood of the whole community, thus leading the scalability of positive results stemming from VSS adoption to be put into question.
- **Limited effects on the livelihood of producers compared to other initiatives**: In order to implement better business practices, companies often need to set up management and monitoring systems as well as record keeping mechanisms, including (basic) traceability systems , which might require whole new organizational units

Sustainability impacts - Social, environmental and ethical management evidence on the ground

Despite positive overall results, research shows that voluntary standards can only be part of the solution in systemic challenges related to environmental and social issues!

Available research also provides important insights into the assessments of VSS performance:

Voluntary sustainability standards are only one tool in the broad set of regulatory options to achieve sustainable outcomes!

Research results greatly vary across countries and communities, and producer groups!