



Green governance

How business ownership affects sustainability

A report of the Business Forum meeting
on 26th January 2010

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About the Business Forum

Ethical questions around climate change, obesity and new technologies are becoming core concerns for food businesses. We have launched the Business Forum to help senior executives gain expert insights into the big issues of the day. Membership is by invitation only and numbers are strictly limited.

The Business Forum meets six times a year for in-depth discussion over an early dinner at a London restaurant. The forum members shape the meeting agenda.

To read reports of previous meetings, visit foodethicscouncil.org/businessforum.

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Introduction

Building a sustainable economy calls for major new investment in low-carbon technologies and infrastructure, renewable energy and ecological protection. Yet only some of this investment will yield conventional productivity returns on a timescale appealing to global capital markets. It follows that greening the economy may call for new models of investment that value ecological and social returns, and for innovative forms of business ownership.

Are we investing enough in sustainable development and, if not, what are the barriers? Are some forms of business intrinsically more sustainable than others? Do businesses that value social returns, such as mutuals, operate any more sustainably than plcs in practice? What regulatory or other factors shape business ownership and investment?

The January meeting of the Food Ethics Council's (FEC) Business Forum discussed such issues. We are very grateful to Sir Don Curry, chair of NFU Mutual, Roger Levett, a leading consultant on sustainability, and Tom Athron, Finance Director of Waitrose, for speaking. The chair was Helen Browning OBE, Food and Farming Director of the Soil Association and chair of the FEC.

This report outlines points raised during the meeting. Contributions are not attributed. The report was prepared by Tom MacMillan. It does not represent the views of the Food Ethics Council, the Business Forum or their members.

Key points

- Global and UK gains in resource efficiency are **outstripped** by increasing consumption.
- The UK's production GHG footprint has been falling but our consumption footprint rising, so we are **offshoring** emissions.
- **Life satisfaction** in the UK has remained constant in recent decades despite GDP growth.
- Some argue that our economy's structural **dependence on growth** is a barrier to environmental and social sustainability.
- So, **mutuals, partnerships and co-operatives**, which are not under pressure to generate short-term returns for shareholders, may be well-equipped to work sustainably.
- However, stakeholder-owned businesses face challenges in accessing **investment capital** and in **financial governance**.
- They operate in the same marketplace as public and private companies, and often use similar **performance benchmarks**.
- In practice, ownership and business models **do not determine** environmental performance.
- The viability of sustainable business practices and investment depends of the wider **competitive environment**.
- Changes in **financial regulation** and pricing **environmental externalities** are other changes, besides ownership, that can affect the competitive environment.
- Instead treating mutualisation as potential driver of sustainability, perhaps policy-makers should see the prevalence of stakeholder-owned businesses as a **marker** of long-term economic health.

Pressure on prosperity

Even as we are being urged to spend our way out of recession – to kick-start economic growth – some economists are arguing that growth is part of the problem. In our economy, our collective prosperity depends on producing and consuming ever more. This can't go on, say critics, in a world of tightening resources, in which our ecological debt deepens year by year. What's more, they argue, the social benefits of economic growth have been diminishing – consuming more doesn't make us happier.

Does the environment really place limits on growth, presenting a fundamental challenge to our economy? Couldn't net growth in the economy – for instance in services or green technology sectors – go hand in hand with decreases in resource intensity and in our overall environmental footprint? 'Decoupling' in such a way is an appealing goal, but it is proving elusive in practice. The overall trend is that impressive gains in resource efficiency continue to be more than outstripped by even greater growth in consumption.¹ In the UK, the GHG impact of production has been falling but our consumption impact is on the up, meaning that instead of shrinking our footprint, we are treading elsewhere.²

Meanwhile, the evidence is growing that growth isn't making us any happier. The

¹ Sustainable Development Commission (2009) Prosperity without growth: the transition to a sustainable economy. SDC, London.

² Food Ethics Council (2008) Food distribution: an ethical agenda. FEC, Brighton.

government's own research shows that for the last three decades life satisfaction has flat-lined in the UK despite increasing GDP. While material needs are still acutely felt in poorer parts of the world, in other wealthy countries it is the same story as here. Once people have attained a certain level of material comfort, other factors, such as family relationships, job security and relative status, become more important determinants of wellbeing than material wealth. Indeed, the pursuit of economic growth can even compromise wellbeing if it impinges on other factors such as these.

It is on these grounds that the UK Sustainable Development Commission, amongst others, argues for 'prosperity without growth'. The Commission calls for changes in economic and social policy that would shift the UK economy, and the world's, onto a different footing. What this might look like is an open question. However, inasmuch as delivering value for shareholders is a major impetus for growth, it highlights the relationship between business ownership and sustainability. Are businesses that are insulated from this pressure, for instance through private or mutual ownership, better equipped to generate social and ecological returns? In short, are they more sustainable?

Ownership and sustainable food

While nobody is saying business ownership is the only issue for sustainability, the idea that it is an important factor is gaining currency. What is the experience of food

businesses? Some of the largest mutual businesses in the UK are in the food sector – are they more sustainable?

As shown by Kraft's takeover of Cadbury, and the threat this has been seen to pose both to jobs and the latter's fair trade commitments, public ownership can put pressure on corporate activities that generate a social return or support a business's long-term sustainability. In part due to regulatory changes since the 1980s, capital markets are currently heavily focused on achieving short-term returns, and highly effective in jettisoning activities that are unnecessary to this objective.

Furthermore, we know that despite the growing prominence of sustainability within the food sector, we still aren't investing enough in sustainable development. There's a recognition among many in the sector that our values and priorities need to change.

Yet, conversely, if any business is to grow in a resource-constrained world is it not the food business? Population is growing and eating isn't discretionary, even if what we eat is. And should we really project a wider social concern about materialism and wellbeing onto the experience of one sector, or of particular businesses within it?

Partnerships in practice

We can get a better grasp of the issues by looking at the real-world performance of food businesses that are mutuals, partnerships or co-operatives –

forms of ownership that insulate them the pressures of shareholder value.

One of the most prominent is Waitrose, the food retail wing of the larger John Lewis Partnership (JLP). JLP staff are partners in the business, which is owned in trust for the benefit of its employees. The partnership was founded in the 1920s, when John Spedan Lewis made the first of two settlements that transferred his shares into a trust. The trust runs the partnership for the benefit of its members: according to its constitution, its "ultimate purpose is the happiness of all its members, through their worthwhile and satisfying employment in a successful business".

The partnership isn't a charity. It has a 5% operating margin, 69,000 employees, 223 supermarkets and a 30% shareholding the home delivery service Ocado. However, the fact the business is a partnership is central to how it works. As it has no shareholders it has to align fewer interests. They reinvest in many ways in their partners, but principally through the partnership bonus – typically about 20% of salary for everyone in the business – and a final salary pension scheme. The two schemes see them invest £300-400 million back into their partners every year. Managers call this JLP's 'rocket fuel'.

Mutual benefits

The partnership has practical benefits for JLP as a business. It reports an incredible level of engagement from staff, who have a clear stake in the organisation. Days off sick are low by

most standards, for example, and the final salary pension encourages employees to think to the future.

The business also sees a number of wider benefits from its partnership, including that:

- It allows them to take a long-term view, as they are protected from the threat of being taken over and the focus on like-for-like sales which that brings.
- The diversity of their business, spread across food and non-food, provides a natural hedge against the ups and downs of the market.
- They enjoy stable relationships with suppliers, evidenced in their above-average farm gate price for milk, taking hail-bruised apples from Kent, continuing to supply fish from Zimbabwe (after careful consideration), and not turning away suppliers who missed delivery windows due to recent snowy conditions.

NFU Mutual, an insurance business owned by its policy-holders, also reports social benefits. While most banks, building societies and insurers have been outsourcing their operations, NFU Mutual has sought to maintain their highstreet presence. They have a 93% retention rate with customers, who are said to value the service and personal relationship with organisation.

These examples and other examples discussed at the meeting suggest that mutuals, co-operatives and partnerships can insulate from some of the harshest pressures of the marketplace. They can

allow businesses to develop a level of resilience that is difficult to replicate in other models. However, we should not see them through rose-tinted glasses, since they face their fair share of economic, social and environmental challenges.

Challenges

One of the most immediate challenges faced by mutuals is access to investment capital. While they are not under pressure to generate value for shareholders, they need investment in order to establish or maintain their place in the market. Because they cannot access capital markets, businesses like JLP need to maintain a credit rating that makes their balance sheets less efficient than they might otherwise be. Generating capital from workers, customers or suppliers is very difficult, and can be a serious limiting factor in co-ops becoming established.

They also operate in the same marketplace as businesses that are public limited companies, and need to compete with them to stay viable. Often this means using the same performance benchmarks, potentially diminishing the practical differences between how businesses with diverse ownership models work in practice.

Governance can be a further challenge. Management in mutuals is spared the short-termism of investor pressure but can get complacent without the scrutiny of shareholders. Their democratic governance structures are effective in voicing member interests at the highest

level of the business, but may be less effective in equipping boards and committees to provide rigorous financial scrutiny.

What about the environmental performance of mutuals, partnerships and co-operatives? The experience in the food sector appears to be that these forms of business in practice perform on a par with public and private companies. Some perform well and find it easy to reconcile environmental values with their social objectives, but there is no simple correlation between ownership and environmental performance. While their ownership structure insulates from some of the market pressures that militate against sustainable behaviour, they share in many other challenges, such as the fact that many environmental costs in their supply chains and operations are externalised.

Smaller co-operatives face many of the same constraints as privately-owned SMEs when it comes to sustainability. They may not afford the management time or money that larger businesses can invest in tackling environmental issues. Policy interventions that make it less time-consuming to improve environmental performance could make a significant difference for small businesses of all stripes.

Growth dilemma

So mutuals have some benefits when it comes to sustainability, yet also face particular challenges. Some of these challenges relate directly to their ownership and governance models,

while others arise from them having to compete in the marketplace against other types of business in a framework where many forms of social and environmental damage still remain cheap or unpriced. If a greater proportion of businesses were mutuals, that competitive pressure might be reduced. Yet because co-owned businesses are not driven by the same impulses as public limited companies to expand or consolidate aggressively, there is no great impetus for them to take a growing share of the market.

Many co-operatives, mutuals and partnerships start small and stay that way. Some have no ambition to grow, which may make it harder for them to maintain impetus and dynamism. Values-led businesses may also struggle to accommodate staff and members with business experience and acumen acquired in shareholder owned businesses. Several people involved in our discussion had sought to establish or to work co-operatively in small businesses at some time during their careers, finding the experience rewarding but difficult. However, support for co-operative and social enterprise start-ups has become more readily available in recent years, and innovations in governance such as Community Interest Companies, set up in the Companies Act of 2006, may help small businesses in this sector to flourish.

This may explain why many of the larger co-operatives, mutuals and partnerships in the UK food sector have attained their scale by the amalgamation of smaller businesses or by transferring

out ownership from private companies, rather than simply growing. However, it is very difficult to persuade owners to give up their capital. It takes either a very long-term earn-back or an act of generosity.

While full-blown mutualisation remains very unusual, the financial crisis has increased interest in more modest changes in governance that can align shareholder and other stakeholder interests. For instance, there has been debate about deferring bonus payments for investment bankers, which would align shareholder and employee interest in a way that has some similarities with a partnership. Similarly, many businesses offer staff bonuses in the form of shares. Whether individuals have an incentive to hold onto these shares or to sell them – as happened during privatisation in the 1980s and 1990s – depends in part on the wider financial market and how it is regulated.

Competitive environment

The viability of sustainable business practices and investment depends on the competitive environment – the rules of the game. How other businesses are owned is one factor in that competitive environment, but by no means the only issue. Other important factors include employment policies, trade agreements and product standards, costs of energy, resources and wastes, and the levels of horizontal and vertical integration within a sector.

Our discussion focused on two wider ways in which the competitive

environment could change to promote sustainability. First, even without radical changes in ownership models, financing could change to place a greater emphasis on long-term returns. For instance, restrictions on how soon after purchase you could sell shares might boost the value of longer-term returns in a similar way that an employee partnership does, in contrast to a system where people can buy shares at lunchtime and sell them at tea. Putting a cost on financial transactions, say through the Tobin tax, might have a similar effect.

A second way of changing the rules of the game is to make environmental externalities, such as water use or pollution, cost more. Moves are already being made in this direction, for instance in regulations based on the principle that the ‘polluter pays’, and in carbon trading. However, many externalities remain unpriced.

Perhaps, instead of treating ownership as a key factor in the sustainability of businesses, we should be focusing on wider factors such as these that affect the competitive environment. If we change policies and incentive systems to make sustainable practices easier, then new forms of ownership and new business models will follow. If we treat ownership as a driver of sustainability, are we putting the cart before the horse?

Conclusion

Unless we rethink our assumptions about economic prosperity and progress, businesses that seek to be sustainable

are fighting against the stream. So we need to change the competitive environment. Financial markets and ownership frameworks contribute to that environment. Changing them can open possibilities, or remove pressures that limit the social, environmental and long-term economic sustainability of public limited companies.

However, it is important to distinguish this overall debate about the rules of the game from discussions about the ownership and performance of individual businesses. While many mutuals, partnerships and co-operatives have impressive tales to tell, particularly about their social impact, ownership and business models don't determine performance. In practice, many such

businesses have little to differentiate them from public or private companies in terms of environmental impact. They also face pronounced challenges when it comes to governance and raising investment capital.

So instead of promoting mutualisation or the emergence of new partnerships as a means of driving sustainability, perhaps the onus should be on policy makers to foster a competitive environment in which all types of business have more commercial incentive to behave sustainably, and business models such as these, which have particular capacity to value social and environmental returns, are able to prosper.

Speaker biographies



Helen Browning, who was awarded an OBE in 1998 for services to organic farming, runs a 1350 acre organic livestock and arable farm in Wiltshire. Helen is the Soil Association's Food and Farming Director and is chairman of the England Animal Health and Welfare Implementation Group. She has worked with many food and farming organisations over the last twenty years, and was a member of the Government's Policy Commission on the Future of Farming and Food ('the Curry Commission'). Helen is chair of the Food Ethics Council.



Sir Don Curry was elected Chairman of NFU Mutual in May 2003, having previously served as Vice Chairman. He is Chairman of the Better Regulation Executive and was previously Chairman of the Delivery Group overseeing the Government's Sustainable Farming & Food Strategy. Sir Don is also a member of the Council of the Royal Agricultural Society of England, a past Commissioner for the Crown Estates and is founder and Chairman of the charity At Home in the Community. Sir Don farms in Northumberland.



Roger Levett is a partner in Levett-Therivel sustainability consultants who specialise in sustainable development policy, planning and appraisal. He co-wrote *A Better Choice of Choice* (Fabian Society), a precursor to current work on life satisfaction and alternatives to growth. Levett-Therivel assessed contributions to the Curry Commission and reviewed the Government's Red Tractor scheme for the Sustainable Development Commission. Roger is currently leading integrated sustainability appraisals of three of the Mayor of London's strategies, helping develop methods to reflect environmental limits in regional planning, and researching methods to reduce ecological footprint for growth areas in the South East.



Tom Athron joined the Waitrose Board in August 2009 as Finance Director. Prior to this he was Buying Director at John Lewis, responsible for Electricals and Home Technology. He joined the Partnership in July 2005 as Head of Group Financial Strategy reporting to the Finance Director. Tom started his career in investment banking as a graduate trainee in credit finance and structured debt at Hambros. After completing his MBA in 1999 he joined Javelin Group, a consulting firm specialising in retail and e-commerce strategy, where he worked with clients including BT, Marks & Spencer, B&Q, and Littlewoods.



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