Food Ethics Council

Fair share-holders

How can investors help us drive fair, sustainable and humane food systems?

A report of the Business Forum meeting on Tuesday 24th November 2015

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About the Business Forum

Ethical questions around climate change, obesity, food security, people and animal welfare, and new technologies are becoming core concerns for food businesses. The Business Forum is a seminar series intended to help senior executives learn about these issues. Membership is by invitation only and numbers are strictly limited.

The Business Forum meets six times a year for an in-depth discussion over an early dinner at a London restaurant.

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

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Introduction

"Pressures to adopt short-term approaches – company performance being judged on the basis of quarterly reports, and shareholder demands for quick returns, for example – militate against longer-term investment in sustainability"[1]. Many financial institutions do not value long-term investments and partnerships appropriately – and food companies feel they have no option but to play by these rules of the game.

Shareholder activism is growing, as fossil fuel divestment campaigns demonstrate. Food companies are increasingly being targeted on issues ranging from health concerns to treatment of workers, environmental impacts to animal welfare credentials. Surely companies and investors should discuss issues more openly and in greater depth? Is there an onus on companies to be transparent in their exposures and plans for mitigation? Does fiduciary duty mean companies have to put shareholders first?

The November 2015 meeting of the Business Forum explored investors' role in driving change; how food companies and investors can overcome short-termist pressures in order to build fair and resilient food systems; and at a case study of intensive animal farming to assess financial risks to investors in the food industry, and investors' role in mainstreaming welfare and sustainability concerns.

We are grateful to our keynote speakers, Jeremy Coller, CIO and Chairman of Coller Capital and Chairman of the Jeremy Coller Foundation - voted by Financial News as one of the most influential people in private equity; Catherine Howarth, Chief Executive of ShareAction, the movement for responsible investment; and Dr Raj Thamotheram, CEO of Preventable Surprises and leading independent strategic investment advisor. The meeting was chaired by David Croft, Global Sustainable Development Director of Diageo and Trustee of the Food Ethics Council.

The report was prepared by Dan Crossley and outlines points raised during the meeting. The report does not necessarily represent the views of the Food Ethics Council, the Business Forum, or its members.

Key Points

- The 'ESG' movement (environment, social and governance) has been building since the UN Principles for Responsible Investment ('PRI') were launched in 2006.
- There is a knowledge gap amongst the investment community about many environmental, social and animal welfare issues, and also a knowledge gap about what can, if anything, be done about them from an investor perspective.
- More and more investors want the companies they are investing in to (at least) 'do no harm', as an ethical bottom line. In tandem, there is also likely to be a rise in the number of investors looking for opportunities to 'do good' and who recognise that doing good equates closely with licence to operate, licence to grow (within environmental limits) and ultimately long-term shareholder value.
- There are numerous possible ways to accelerate positive change, which might include: (i) ask investors to acknowledge material welfare issues (ii) appeal to competitive instincts via ranking (iii) consider introducing a standard of standards (iv) promote a long term horizon (v) encourage leaders and first followers and (vi) explore the divestment case versus active engagement.
- It was argued that the investor case is about materiality not morality, i.e. that the arguments are likely to be more effective if they are about making or saving money, or about managing risks.
- Many people have grown up at a time when noone seemed to worry about what they ate. But now it is becoming more obvious to more people that 'you are what you eat'.
- Surely the point will soon be reached where people realise 'you are what you invest in'. How quickly that happens remains to be seen, but the role of investors in influencing the future direction of food and farming is likely to only grow. Food and farming businesses should ignore investors at their peril – and similarly investors should ignore material sustainability concerns at their peril.

[1] Food Ethics Council (2012), Beyond Business As Usual
http://www.foodethicscouncil.org/uploads/publications/2013%20Beyond%20Business%20As%20Usual.pdf

The rise of 'PRI' and 'ESG'

The 'ESG' movement (environment, social and governance) has been building since the UN Principles for Responsible Investment ('PRI')[2] were launched in 2006. The PRI were developed by investors and supported by the UN, and now have more than 1,400 signatories from over 50 countries. This represents more than US$59 trillion of assets[3], which is around one-third of the world's investable capital.

One example cited was Actis, a private equity group and fund of funds that invests in emerging markets. It insists that when a company is building a textile factory in Bangladesh that it has a fire exit and foundations. It was suggested that this is not primarily to do with human rights or ethics; instead it is simply good business.

The accusation is sometimes made that Corporate Social Responsibility is simply lip service for brands. it was claimed though that ESG is very different – and that it has huge potential for transformative change. If an investor tells his or her investment manager that they can not invest in a company with child labour, the investment manager must follow that. 'Environment' issues relate to material environmental factors such as climate change and pollution (as with BP and the Deepwater Horizon oil spill). 'Social' concerns include human rights, diversity and animal welfare. 'Governance' refers to issues such as Board composition and remuneration, where there are often formal votes hard wired into the process, so there is a compulsion mechanism.

The growth of the PRI and ESG has been spectacular to the extent that it is much bigger than the UN Global Compact and it has grown past a numerical tipping point. However, a note of caution was sounded as to whether ESG is actually positively changing the investment world. Examples were cited of companies that were until recently held up as leaders in sustainability.

Volkswagen was previously a leader on the Dow Jones Sustainability Index before the scandal about misleading emissions figures from its vehicles. Similarly, BP was a leader in ESG reporting, viewed as best in class and a darling of the investment community before the Deepwater Horizon oil spill pushed health and safety concerns to the forefront. Sustainability rankings and the ESG movement have been damaged as a result of these – and other – examples. Some people are arguing that self-reporting should be replaced with more independent assessment.

UN Principles for Responsible Investment

"As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that ESG issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following [six Principles]:

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles."

Investor knowledge gaps

Food and farming companies are in many ways exactly like companies in other sectors. Investors are interested in companies with strong management, good governance and robust plans for the future.

There are some issues food and farming share in common with other sectors, but where food and farming have a relatively very high impact – with climate change being a prime example.

Then there are issues that are only pertinent to food and farming. Farm animal welfare and health and nutrition are two such issues. These issues require specialist knowledge. Hence it is perhaps not surprising that most institutional investors have not yet incorporated these concerns into their investment decisions.

It was argued that there is not only a knowledge gap amongst the investment community about many environmental, social and animal welfare *issues*, but also a knowledge gap about what can, if anything, be done about them from an investor perspective.

[2] http://www.unpri.org/about-pri/the-six-principles/

[3] http://2xjmlj8428u1a2k5o34l1m71.wpengine.netdna-cdn.com/wp-content/uploads/PRI_AnnualReport2015.pdf

'Factory farming' – inconvenient truths

It was claimed that there are four inconvenient truths about 'animal factory farming' - that are financially material and also material to the wellbeing of people in pension funds:

1. *"It threatens human health"*

   It is claimed that 80% of all antibiotics in the US 50% in Europe are used on factory farms. The use of antimicrobial drugs (antibiotics) in farming has come under increasing scrutiny because of fears that their overuse in animals speeds the development of drug resistant human and animal diseases.

2. *"It contributes to global warming and pollution"*

   The livestock industry is the second largest contributor to climate change globally, contributing 14.5% of greenhouse gases. Despite the widespread recognition that there will be (and arguably already are) very heavy costs to pay in relation to climate change, somehow this hugely significant GHG-emitting industry has managed to remain largely below the radar. From an investors' point of view, climate change is very relevant not just in terms of risk management, but also from an 'upside' (opportunity) point of view.

3. *"It exacerbates undernourishment/ world hunger"*

   The argument was put forward that more and more food is being grown to feed animals and, relatively speaking, less and less, is being grown to feed humans directly. On closer examination, some of these practices intuitively feel somewhat absurd e.g. it takes 4kg of wild fish to produce 1kg of salmon. Given there are over 800 million people undernourished in the world, this begs important questions about society's use of resources and how it priorities them.

4. *"It consumes our planet's scarce resources"*

   It was reported that livestock production uses at least one quarter of the world's fresh water and it takes more than 1,000 litres of water to produce 100 calories of beef. Also, it was argued that 85% of all soya globally is used in animal feeds.

Factory farming was purported to have only really started in the 1960s. Since then, population growth has outstripped the amount of arable land, but also cereals grown for animals has increased by a factor 3.3, in comparison to cereals grown for humans, which have only increased by a factor of 1.6.

Materiality not morality?

It was argued that the investor case should be about materiality not morality, i.e. that the arguments are likely to be more effective if they are about making or saving money, or about managing risks. It is worth noting that the 'investor case' and 'the business case' are not interchangeable – the two of them can be very different. 'Socially responsible investment' has grown in the last few years, but such 'ethical investment' (or *more ethical* investment) still remains niche.

It was suggested that animal welfare issues suffer somewhat within the responsible investment world from having strong associations with ethical concerns people have about animals. Because many people understandably get very worked up about animal welfare concerns, it may fall into the trap within the institutional investment world of people thinking that it is a moral or ethical issue, outside of their fiduciary duty. The risk here is that they may not be aware that animal welfare concerns are often associated with sizeable financially-relevant risks.

SeaWorld, a private equity-backed, public company, saw its share price affected by claims of animal cruelty. The documentary 'Blackfish' in 2013 claimed that SeaWorld mistreated its orca whales. Subsequently, attendance and turnover fell, plus the share price fell by 50%, and the former CEO left. This demonstrates that animal welfare concerns (albeit not farm animals in this instance) can have a material negative impact on share price.

A growing number of people are beginning to wake up to the fact that if they have strong views on e.g. climate change, then their pension fund is arguably the most important vehicle for having an influence on that issue than anything else they can do in their personal life. Even if they have changed their light bulbs to LED, have taken a few less flights, are composting and more, against all that the impacts of influencing one's pension fund can be very significant.

In relation to highly emotive issues such as farm animal welfare, it was claimed that many people with ordinary pensions and savings feel hugely indignant, angry and upset by what happens to farm animals. So in terms of mobilising 'bottom up' action, appealing to morality arguments may be fruitful – especially if combined with arguments about the long-term financial impacts on their savings.

Investment community

It was claimed that there are (at least) four types of people operating in the marketplace of the investment community:

1. '*Happy imbeciles'* – those disinterested in issues such as climate change (i.e. what others would strongly argue are realities). It was suggested that the current reality is that climate change is not a top ten issue amongst the mainstream investor community.

2. '*Supportive pessimists'* – people who know about an issue, but argue that they can not make a judgement for a whole host of reasons.

3. '*Free market fundamentalists'* – a large proportion of those in the investment community who would argue that if something is material, it will end up being reflected in the share price, and if it is not, then it will not. If and when the share price does change, they have a self-reinforcing logic of why it has entered into the share price. The efficient market hypothesis spawned the modern portfolio theory, which has driven much of the investment industry in recent decades.

4. '*Sustainability smooth talkers'* – a growing group of players with positive intent. However, they are often marginalised and perceived as a cost centre.

Investment systems are arguably over-intermediated, with a multitude of credit rating analysts, investment consultants and sell side analysts – the best of which get very good access to the Chairmen and CEO of major companies. Each of these intermediaries has an incentive not to than to worry about anything other than their own interaction in the chain – hence it was suggested that many are resistant to integrating ESG.

Possible ways of accelerating change

Ask investors to acknowledge material welfare issues

Farm Animal Investment Risk and Return is a network that is asking investors to sign up to three principles: (i) to consider (as a starting point) farm animal welfare ('FAW') in their investment decision-making processes; (ii) to consider FAW in monitoring their investments and (iii) to support transparency.

Appeal to competitive instincts via ranking

One suggestion was to publicly rank the major investment firms or broking firms to try and create commercial competition to focus on material environmental, social, health and farm animal welfare factors. People in organisations at the top of the rankings would feel proud, whilst those lower down might be increasingly asked by clients why they are languishing at the bottom of the rankings. It was felt that a ranking of that kind could be a great opportunity in the retail investor space – a potentially powerful pressure point, endowing investors with competitive advantage (or disadvantage).

When done well, with good comparable, robust data and independent scrutiny, such rankings can be very effective. The example of sustainable fish in the retail world was cited, whereby the leading retailers really care about coming out top of the rankings. It was suggested that the investment community is perhaps five to 10 years behind the corporate world in accepting transparency, but that the investment world is coming under more and more pressure to improve transparency.

Strategies like independent rankings are even more important when Government is reluctant to intervene e.g. on mandatory reporting, as appears to be the case in the UK at present. The counter-argument was put forward that rankings may have the desired short-term effect, but in the long run, competitive pressures will not ever replace the need for better regulation.

Consider introducing a standard of standards

Different companies use different assurance schemes, that are often not comparable. Many assurance schemes focus on single issues and have very specific requirements. Is it possible to have an overall ranking that gets people to work on developing the criteria together in a very genuine way? And could an outcomes-related benchmarking process be carried out on a whole range of issues? That would have to work alongside, rather than replace, mandatory reporting.

The Food for Life Catering Mark was suggested as a strong early example of a 'standard of standards'. It embraces a range of standards and is clear about the progression that caterers would go on to get from bronze to silver to gold.

Promote a longer term horizon

A gradual shift is emerging away from quarterly guidance – the management commentary that attunes investors to what the share price might be. Such a move is welcome, as it allows corporate directors to focus on producing results over a longer time frame, which allows them to incorporate factors that are meaningful over the long term.

It was argued that pension funds are now demanding less quarterly reporting from the asset managers – and that there are two drivers for that. The first is the asset managers who want to invest on a longer-term basis. The second is governance pressure and burden.

Large pension funds allocate money to individual asset managers, who can have a very short-term perspective. But a large well-diversified pension fund is – in responsible investment jargon - a 'universal owner' and becomes very exposed to issues like the rise of antibiotic resistance and climate change, which start to be very costly. So long as funds define their objectives and duties as quarter by quarter outperforming a benchmark, they will get stuck inside of not really focusing on challenging companies to tackle those unsustainable practices, because in the long-term, they have big impacts on the wider portfolio.

Encourage leaders and first followers

Paul Polman from Unilever was cited as a leading CEO who has been actively discouraging short-term investors in the business and has instead been encouraging them to invest for the long run. He moved Unilever away from quarterly reporting. He is not alone – there are a growing number of companies working on different elements of health, environmental sustainability, social justice and animal welfare, e.g. a number are working on natural capital projects.

There haven't been many 'first followers' and certainly not enough visionary leaders. However, Paul Polman has helped make it more acceptable for other corporate leaders to encourage long term thinking and long term investment.

Divestment versus active engagement

Some argue that divestment can be a very powerful tool, as with the recent fossil fuel divestment campaign. Others argue that divestment is not a solution to issues such as climate change or indeed farm animal welfare concerns. Divestment is a tactic which helps raise the profile of an issue, but it was claimed that active stewardship or active engagement might be more effective in the long run.

Investors and companies alike can play a positive role in encouraging staff to participate in a positive agenda around pensions – because many employees are now shareholders, i.e. owners of pension funds.

Final thoughts

More and more investors want the companies they are investing in to (at least) 'do no harm', as an ethical bottom line. Over time, that is likely to only continue to grow. In tandem, there is also likely to be a rise in the number of investors looking for opportunities to 'do good' and who recognise that doing good equates closely with licence to operate, licence to grow (within environmental limits) and ultimately long-term shareholder value.

Many people have grown up at a time when noone seemed to worry about what they ate. But now it is becoming more obvious to more peope that 'you are what you eat'. Ethical investing has gone beyond tokenism and ethical screening towards a sense of "I am reflecting who I am in my investment choices", including who people invest through.

We will surely get to the point where people also realise 'you are what you invest in'. How quickly that happens remains to be seen, but the role of investors in influencing the future direction of food and farming is likely to only grow.

Food and farming businesses should ignore investors at their peril – and similarly investors should ignore material sustainability concerns at their peril.

Speaker biographies

Jeremy Coller is CIO & Chairman of Coller Capital. Jeremy pioneered and industrialised the private equity secondaries market. His firm, Coller Capital, has invested in over 5,000 private companies worldwide and has approximately $10bn of assets under management. Financial News has voted Jeremy one of the most influential people in private equity in each of the past four years, plus named him 'Personality of the Decade' in Europe in 2013. As well as being Chairman of the Jeremy Coller Foundation, his vehicle for philanthropic activities, he started the Coller Institute for Private Equity at London Business School and the Coller Institute for Venture at Tel Aviv University. He is a member of the Advisory Council of The Elders. Jeremy is the author of The Lives, Loves and Deaths of Splendidly Unreasonable Inventors. He is a vegan.

Catherine Howarth is Chief Executive of ShareAction, a non-profit organisation that promotes responsible investment by institutional investors. ShareAction demands transparency and accountability to the millions of people whose savings are managed by investment professionals. Catherine is a board member of Green Alliance and of the Scott Trust (owner of The Guardian). She also serves on the investment committee of Trust for London. One of ShareAction's major programmes addresses the sustainability challenges and investor risks associated with intensive animal farming. In June 2011 Catherine was named a 'Rising Star of Corporate Governance' by Yale University's Millstein Center. In 2014, the World Economic Forum selected her as a Young Global Leader.

Raj Thamotheram is CEO of Preventable Surprises and Visiting Fellow, Smith School, Oxford University. He is a well-recognised thought-leader on long-term wealth creation. He lectures, facilitates high-level discussions and provides strategic advisory support and training to investor clients. Previously, he led ESG teams at USS and at AXA IM. Raj was nominated by Global Proxy Watch as "one of the 10 most influential figures in corporate governance" in 2004 and 2008 and is co-founder of the Network for Sustainable Financial Markets. He is a trustee of the Friends Provident Foundation and a member of the board of Council on Economic Policies. He is co-author, with Howard Covington, of the Forceful Stewardship initiative, a proposal that institutional investors trigger the shift to a 2C world by asking investee companies to produce business strategies and plans aligned with this outcome.

David Croft is Global Sustainable Development Director, Diageo. David's previous experience includes Waitrose, Kraft Foods, Cadbury and the Co-operative Group, where his senior roles have included leading technical and marketing functions in environmental sustainability, ethical sourcing and retail standards. He has contributed significantly to the development of the UK fair trade market, launching new products and ranges, and by developing consumer awareness and marketing campaigns. David is a Trustee of the Food Ethics Council.

(*David chaired the discussion on the evening)*