Text of Presentation prepared for Faith Business Conference
Ridley Hall – 27th March 2010

[*NB Text as delivered was adapted to respond to earlier speakers..*]

My context is to explore how alternative business models can add social value – and drawing on my own experience of different social enterprise.

I want to begin by painting very brief pen pictures of 5 different enterprises

- One works in the field of education. It has allowed two domineering chief officers to bully and intimidate staff. The second chief officer frankly ran a regime of rampant nepotism by-passing established recruitment procedures appointing friends and relatives to the staff, knowingly falsified performance statistics and ran up a budget deficit
- Another is involved is in the restaurant trade. Its idiosyncratic values meant that it refuses to take reservations (too elitist), regularly drops items off the menu if the kitchen staff did not feel like preparing that item and closes for an hour at midday so that the staff can take their lunch-break
- A third is involved with the visual arts. Through the leadership of one individual and the support of small group of professionals it has developed from a small cafe/gallery with a few £100's in the bank to the project lead for a £3/4 million new build arts centre.
- My fourth is involved with event management. Despite handling public funds its management is evasive and unco-operative, its accounting practices opaque, and it is widely perceived as having 'bent' restricted funds for its own purposes
- The last example draws upon my fair trade days. It is involved with rural agriculture. It is a model employer operating a food security programme for its workers, offering them land on which to grow their own kitchen crops, and it contributes towards basic medical care and schooling.

My five examples each have different legal forms – one is in the public sector, one a co-operative, another a CIC [Community Interest Company], another a registered charity, the last a sole trader.

It won't especially surprise you that it is less the legal form which determines ethical practice (and public benefit) than the people involved. In my examples the sole trader (in Malawi) was the exemplar of a community anchor organisation. The charity and the public sector organisation (a school) were the worst because each had a 'rotten apple' at the helm.

Therefore I am tempted to say – forget the alternative structures – there is good and bad in all sectors – '*By their fruits ye shall know them*' . But I suspect that our hosts would consider that my invitation was wasted if I ended there..

And so I want to offer some thoughts on different uses of the value added chain, different forms of governance and different approaches to accountability. I will focus upon enterprise because that's what I know best.

VALUE ADDED

The process begins for me crucially with an understanding of the value-added chain.

Private enterprise operates on the principle of seeking to maximise the long-term share of value added going back to the shareholders/owners. Thus a taxi firm, a private restaurant, a supermarket, an airline, a bank will all be seeking to set prices which maximise the gross profit earned from customers – supermarkets squeeze suppliers and cuts out costs (these days we weigh our own produce and handle our own checkouts), airline strip out costs (no frills) and pass on extras, banks automate to reduce transaction costs, taxi firms and restaurant keep wages as low as possible and rely on tips to supplement income.

The customer receives value – or at least can shop around for the cheapest deal which may not be the same thing. The owners seek to maximise the profits of the endeavour [That may involve paying bonus and other rewards to key staff]. That's what the business press concentrates on– sales growth and profitability.

What makes alternative structures or social enterprises (of all kinds) different is that they intervene into the value added chain in a different way.

Co-operatives seek to share the benefit of enterprise amongst co-operative members. It may be a supplier co-op (eg an agricultural co-operative), a worker co-op (as indeed was the Blue Mango restaurant in California – the one which rather lost sight of the customer proposition by deciding that it should close at midday whilst the staff had their lunch), or a consumer co-op (as is the Co-operative Group). Sometimes supplier and consumer co-ops differ little from their private enterprise equivalents, because once they grow to scale they are still run by a 'professional' management and the social benefit is still largely measured in financial return to members, their dividend.

Indeed the dangers of 'professional management' losing sight of the co-operative principles are well illustrated by the fate suffered by some of the de-mutualised Building Societies. Demutualisation saw the accumulated value of co-operative endeavour distributed as shares to members - which the 'not so professional' management then proceeded to make virtually worthless by poor risk management – *ask any shareholder in Northern Rock.*

However co-operatives can and do behave differently - the Co-op Group and the John Lewis Partnership (if I may group them with co-ops) - have been amongst the active distributors of fair trade produce in the UK

But you don't have to be a Co-op to offer an alternative structure – back to the value added chain

Classically fair trade companies – like Traidcraft which I used to run – work quite hard to re-order the value-added chain. We invite the consumer to pay a premium, we reduce some marketing and distribution costs by involving volunteers, we have a flat-ish pay structure which (on balance) probably keeps payroll costs lower than in the private sector and we ask investors (shareholders) to invest for little or no return.

We then seek to pass on the benefit of those sacrifices against market return to our primary beneficiaries – producers in the developing world. We do this in the form of fairer terms of trade (usually better prices but also advance payments, continuity of orders and technical support) – the obverse of the cost minimisation strategies for which supermarkets and big brands are taken to task.

Other social enterprises will serve other beneficiary groups – eg adults with learning difficulties or those at risk of offending. Each tries to use a different approach to the value-added chain to channel the rewards of enterprise to their chosen [marginalised] beneficiary group.

There are usually inefficiencies in the system – which effectively means that there is a friction in alternative structures:

- Lack of economies of scale
- Imperfect market knowledge – the cost of gathering data
- Social accounting or social auditing
- Governance structures

GOVERNANCE

So is a particular governance form necessary for the successful delivery of social value added? I think you can guess from my introduction that my answer is 'No'. Indeed - within the fair trade arena alone I can think of examples of respected and durable enterprises which are: private limited companies, growth organisation attracting venture capital, plcs, industrial and provident societies, worker co-ops, producer co-ops, consumer co-ops, para-statals and development charities with trading arms. All doing fair trade and doing it well...

What the right governance structure can help you to do is to secure the benefits you are trying to deliver more reliably and purposefully.

There is a perception of social enterprise from the United States which suggests (persuasively) that you can get rich <u>and</u> do social good at the same time. I am afraid I find that at odds with my understanding of the value added chain. You can indeed develop successful brands which are aligned with social values (eg Body Shop, Ben & Jerry's, Innocent Smoothies) – the so-called 'passion brands'. But a) history suggests that as the 'passion' is commercially exploited they tend to go private [the brands are bought out]], and b) I would argue that their aim for the most part is not to <u>maximise</u> social return – but to deliver social value as a product of their pursuit of distributable shareholder value. Thus they are more akin to good old fashioned philanthropy – see diagram – using the profit stream to support charitable objectives

[That rather blunt conclusion does not do adequate justice the vision and enterprise of the founders of some of these organisations – Anita Roddick, Ben Cohen and Jerry Greenfield, Adam, Jon & Richard – they were indeed breaking new ground in consumer branding - and have delivered a whole bunch of good. But I stand by the substantive distinction – if someone gets very rich by promoting a passion brand, they have missed the opportunity maximise social value.]

So what other structures may be available to us to deliver social value? Here we do well to hold in mind the useful mantra – **Structure follows strategy** – ie 'be clear what you are trying to do, and then go look for the structure which will best allow you to do it well in your particular circumstances.'

Here are some obvious examples (with which I guessing everybody will be familiar on paper at least, if not from first-hand experience)

Trading Co. owns Charity

We have already touched on this. Many plcs have spawned Foundations – some of those Foundations have had significant influence. But they also face dilemmas – the work of the Foundation can be frustrated by the failure of the parent business. Banks sadly come to mind once again – Barings, Northern Rock Foundation. Or on occasion the work of the parent may be in conflict with the interests of the charities' beneficiaries – take smoking, alcohol and gambling for instance.

Richer Sounds, the discount hi-fi store, channels approx. 15% of its profits into charitable organisations, making it one of the most generous donors (in percentage terms) of any company in the UK.

Co-operative Model

In many ways the Co-operative model is the purest forms of governance – one member, one vote – no disproportionate influence given to 'capital'. But Co-operative governance can also be a) pains-takingly slow, and b) a hostage to the self-interest of members (which may or may not be aligned with the interests of the other stakeholders/the long term health of the business). And precisely because capital does not hold influence, many co-operatives are under-capitalised relative to their market potential.

Charity owns Trading Co

We encounter this in two guises a) charities seeking to separate their trading activities for tax/risk purposes [Thus Oxfam, Cancer Research, etc], and occasionally in the form of a business gifted to the Foundation [eg Welcome Foundation]. A problem which may arise with this structure is the obligation upon the Charity Trustees to maximise value for charitable objectives – thus when a good enough offer is made for trading subsidiary, or it that latter is is in trouble, the Trustees may feel obliged to act to maximise cash value (even if their views of social value may see things differently – eg impact upon local employment]

Unitary Board

This is the structure eventually adopted by Traidcraft – and followed (with variants) in other places – Shared Interest, Twin Trading – one Board controls the trading company and the charity (where there is one). The Directors (because they are directors of both the trading company and the charity) are able to view the enterprise as whole – but the tax and other benefits of separating charitable activity from trading activity are preserved

Community Interest Company

CIC's were introduced by the government in 2004/5 as a purpose-built vehicle for social enterprise. In many respect they are little different from Companies Limited by Guarantee in the they include an 'asset lock' – but they bring two other advantages They permit the issue of investment shared and they are required to submit an annual Community Benefit Statement, (as far as I am aware) the only legal form business (I am excluding registered charities) which is explicitly charged with reporting annually its contribution to public benefit.

ACCOUNTABILITY

Now this latter innovation and leads me to a final 'litmus test' – Accountability. For all of our efforts after the new Labour Gov't came to power (*do you remember when New Labour was new?*) the reform of the Companies Act only marginally advanced the public accountability of limited liability companies. And so on my interpretation (next diagram) – the main line of accountability of companies is to their members. Accountability to employees and other business partners it is a matter of employment and contract law – and to the community at large is acknowledged usually in some voluntary code of 'corporate social responsibility'. One may argue (fairly) that in many parts of our lives we are over-regulated by nanny state. Nonetheless I would still argue that society has sold the benefit legally-backed limited liability too cheap. If we limit the liability of those who engage in risky business should not society be asking for more public accountability in return?

One of the defining characteristics of alternative structures is most often commitment to transparency – Traidcraft or cafedirect to its shareholders, Shared Interest or the Co-op Group to its members, and so on. Earlier in this conference we were shown a model of 'Trust' – this included an element of 'intimacy' or self-disclosure. If you are going to make ethical claims for your business, you need to back up your claims with a system which demonstrates that you walk your own talk.

Thus I would argue what links (or should link) the different approaches to value added and governance, is a form of triple bottom line accounting to stakeholders.

A triple bottom line account recognises that there are trade-offs between financial, social and environmental return – and that different enterprises give different weightings to the three – according to their business purpose. I have no problem with some enterprises may declare baldly: '*Our aim is the maximisation of financial return, and our social and environmental objectives go no further than is required by statute*'. Then we know what their priorities are and what kind of relationship we can expect to have with them. But explicit recognition of this kind would represent a major step forward in disclosure today's accepted practice which is to pretend that we need only account for our three dimensional world, in one dimension (money).

[The Trinity has been something of a recurring motif through our conference. Is it a co-incidence that in Triple Bottom Line reporting we find a more rounded way of accounting for our 'stewardship' of God's creation. I think it is Dorothy L Sayers in her book 'The Mind of the Maker' who suggests

that If we have the eyes to see we will find the mark of the creator all around us. The celtic tradition offers a similar perspective. No surprise therefore that in searching for God's way of doing business, the notion of a relational Trinity recurs]

Those who do triple bottom line reporting well find that it becomes a learning tool which informs strategy – another maxim ' what's measured is what matters' might better be extended – 'what's measured <u>and reported </u>is what matters'.

I have illustrated the 'learning organisation' in the context of the management process. The same process can define application of customer feedback – disclosure informs 'curious customers', customers ask questions, questions tell businesses about their customers' concerns, businesses can re-balance their priorities to align them more closely with customer values.

To conclude I want to share a slogan from my early days at Traidcraft (when we were still quite anti-capitalist in some of our thinking). I have it still hanging above my desk which says: '**Rich man, Poor man, Middle man, Thief**'. Most of my active involvement in business is an intermediary – a middle man. My banner serves a s daily challenge to me – are the choice which I make as an economic actor Kingdom choices?

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