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21st CENTURY CAPITALISM ***The Change From Inside***

Vision Paper: Real Shareholder Value

Sustainability is not breaching through the vested interests of Capitalism. Meanwhile, Capitalism is destroying itself. This paper explores a synthesis between both problems and interests by a 'Paradigm Shift' from inside Capitalism

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About the author

Roland J.I. Menke has been working for 23 years in the field of Corporate Finance & Business Development.

After getting his university degree in business economics and his post graduate degree as registered financial controller he started as a banker with NIBC in The Hague. Subsequently, he worked for 9 years as financial director for the multinational Royal Nedlloyd. With his substantial experience in international turnaround and M&A-processes within Nedlloyd, he started his own business in 1997 Menke Corporate Finance & Venture Capital. Furthermore, he has been the financial & strategic advisor for more than 15 years to his family business, a successful medium-sized construction company

Besides almost 25 years of focus on the 'P' for Profit, he has been driven for some 10 years by the notion of sustainability. This is reflected a.o. in this paper, which is based on his current doctoral research.

At present he spends a lot of time in creating support with pensionfunds, multinationals, banks, chartered accountants and political parties for the advocated 'Change from Inside'.

Roland is married to Marian, who works as an oncologic surgeon in the ErasmusMC Clinic in Rotterdam. They have 3 children.

Real Shareholder value

The Free Planet problem of Capitalism

From the start of the credit crunch there has been a call for a new form of sustainable capitalism. Governments have taken clear steps to direct and assume the general responsibility for the revolution toward a more sustainable world. It is evident from recent research that climate and energy agreements between governments and the industrial sector do not work. Within the context of the intended sustainability measures, the industrial sector is demanding governments to ensure an international competitive 'level playing field'.

Businesses, pension funds and other institutional investors have a significant self-interest in playing a prominent role in the sustainability revolution. The sombre future scenarios for life on our Planet put forward by renowned institutions such as the IEA, World Bank, MIT, IPCC, WNF etc. have significant consequences for the shareholder value of businesses. By discounting future business cash flows, shareholder value effectively calculates the future back to now. However, the discounted cash flows do not include the effects of business activities on the Planet leading to the aforementioned sombre future scenarios. Whilst the Planet's resources such as fertile land, fresh water, fishing grounds, good living environment, biodiversity, stable climate etc. are becoming increasingly scarce, the use of them still has no price in an economic sense ('Cost of Planet'). Until now our Planet has been available free of charge and has therefore been drained without limit.

Due to the increasing scarcity of resources, this assumption of a free Planet is no longer tenable and is even unethical towards ourselves as humans, because it is a threat to our very existence. From a business perspective it is therefore unwise to ignore this Cost of Planet. The impact of the Cost of Planet on shareholder value should be a serious boardroom issue for businesses, pension funds and other institutional investors; maximisation of shareholder value is, after all, the main driving force behind the current Anglo-Saxon capitalist system.

The Huge Power of Capitalism

Maximisation of shareholder value links seamlessly to the oldest and most dominant part of our brains, the hypothalamus; a combination of neurological and behavioural research shows that this is where the strongest human impulses reside, including status orientation, the lust for power and greed. A manager in a business who is good at maximising shareholder value is awarded a higher position (which appeals to status and power) and a higher salary (which appeals to greed). Capitalism is thus being driven by 1 billion of the strongest human impulses in the 1st world, while appr. 5,5 billion people worldwide would like to jump on the bandwagon, with the Chinese and Indian population up front. This explains the intrinsic power and success of capitalism, which is considered to be the best system ever. Her power is also her weakness. Capitalism is self-destructive because of the unchanging and unrestrained character of our strongest human impulses.

The Weakness of Sustainability

Sustainability primarily lacks such a similar universal driving force and therefore it does not breach the vested interests of capitalism. The Cost of Planet make the Real Shareholder Value visible and this links sustainability up to the power of capitalism.

Capitalism is destroying itself

What is the relationship between Cost of Planet and shareholder value? Our Planet is 'the super machine' which forms the basis for all life and human activity. Yet it is precisely this super machine which is being swiftly eroded, due to the fact that each year we use 1.4 times more of the Planet than it produces. This is the so called overshoot factor (Living Planet November 2009). Deforestation, desertification, chemical pollution of water and air, erosion of the fertile topsoil, decreasing fresh water supplies, decreasing supplies of rare metals and declining biodiversity are the consequences. Whilst the productive part of our Planet is declining increasingly faster, the world population will increase from 6.5 billion to 9.2 billion in 2050 with a higher average consumption level than today. Our strongest human impulses are unrestrained and the media continuously appeal to them on the basis of status anxiety (de Botton) and the theory of relative incomes (Layard). As a consequence we have ended up with an increasing number of people in an endless consumption spiral. A food, water, energy, biodiversity, climate and environmental crisis will be the consequences (The World Bank). Mankind is quite literally eating into its greatest and most fundamental capital: The Planet.

Mankind eating into its fundamental capital also has serious consequences for businesses. After all, without a habitable planet there will be no People, not to mention Profit. Increasing inhabitability as a consequence of the aforementioned demographic developments is going to increasingly inhibit business activities. People generally and in their roles as employer, employee, consumer and investor will be forced to spend more time on survival, first of all in the 3rd world and later globally. Food, energy and water shortages as well as environmental, political and climate catastrophes all reduce employability, productivity and also the availability of operating staff. The diminishing availability of staff, but also water, energy, rare metals and raw materials and increasing environmental pollution threaten business continuity.

These developments relating to raw materials, energy, food, water, biodiversity, environment and climate and their effect upon staff not only damage the production process but also consumers' disposable incomes, so that businesses are also going to experience increasing problems with their sales. In addition the costs which arise from climate change (€ 10,500 billion - IEA) and other crises will have to be borne.

The IEA recently established that, despite all of the political intentions, a de facto "unchanged policy" still exists. The continuous upward trend in the world's overshoot factor is a clear and simple signal in this respect and it is in line with the estimates that we need more than 3 productive planets by 2050 to support ourselves. Although intolerable, this is the result of the aforementioned consumption spiral. Profitability and thus shareholder value and capital available for investment will fall during the course of these developments. This is precisely where the interests of businesses, pension funds and other institutional investors lie in playing a prominent role in the realisation of a sustainable world and paying attention to the Cost of Planet. The Cost of Planet and its effects on shareholder value are inescapable. Indeed, more than that, the effect on shareholder value is here already, it has just not yet been made visible.

Synthesis between the interest of Capitalism and Sustainability

Adopting the Cost of Planet as an investment criterion simultaneously solves the problem of capitalism i.e. 'how can it stop the destruction of Real Shareholder Value and of itself as a system' and it solves the problem of sustainability i.e. 'how can it develop a power as huge as capitalism', so that sustainability finally breaches vested interests? It's interesting to see that the fiction of the free Planet is at the heart of both problems and that this fiction can be abandoned through Cost of Planet.

Determination of the Cost of Planet

How are the Cost of Planet to be determined? They consist of a volume and a price component. The scientifically based measuring system of the 'Ecological Footprint' has existed since 1996 (Rees & Wackernagel). The Footprint measures the quantity of productive land and ocean which is necessary to produce the natural resources for our consumption and infrastructure, together with the space which is required to absorb CO₂ emissions and waste. The space and energy usage, expressed as the number of hectares used annually, can be calculated for every product, service, individual, business, organisation or country. This is the Footprint (www.footprintnetwork.org). The EU Commission qualifies the Ecological Footprint at this present time as the best measuring instrument of sustainability related to the Planet.

The Footprint is a good management tool with a view to the crises referred to earlier. This is because the Footprint reflects the effects on food production (productive hectares), on climate and energy (the CO₂-Footprint comprises appr. 40-50% of the Ecological Footprint), on the difference in welfare between the 1st and 3rd worlds (Footprint scale per country), on biodiversity, on water usage (Water footprint) and on the environment (productive hectares required for the absorption of waste).

In addition to this, the Footprint is an outstanding global means of communication for sustainability related to Planet due to its simplicity and uniformity. Everyone, from businesses and pension funds to consumers, NGO's and governmental authorities can work with the Footprint and speak the same language. Businesses have all the information required to determine their own Footprint at their disposal within their systems. In the UK, the Footprint is already stated on product packaging.

What is lacking is the price per hectare per year, which triggers the question: 'What is the value of our Planet?' The value of the Planet is ultimately indeterminate as this value is infinitely great, varied, immaterial and immeasurable. The capitalist system on the other hand, precisely due to its restricted scope, does offer guides for value determination. And since this system determines a large part of human activity, value determination from this perspective seems is relevant.

From the capitalist perspective, the Planet is 'merely' a production resource. It is the underlying super machine, with its 13.4 billion productive hectares (Living Planet Report 2008), which puts us in the position to generate global annual GNP which in 2008 amounted to \$ 60,115 billion (World Bank). This is the current 'assumed perpetual earning capacity' of the Planet and therefore also the 'value at risk', which will be lost if the productive hectares on our Planet are reduced to 0 in the extreme case. Given the unpredictability and the irreversibility of changes to complex eco-systems in conjunction with the irreplaceability of our Planet and its resources we can allow no calculation of probability in respect of the consequences of our current actions. A worst case approach is wise here, if only to clarify the seriousness of the situation.

The utilization costs of the Planet from this strictly capitalist perspective therefore amount to \$ 4,500 per ha/year ('Cost of Planet'). This is an immediately usable simplification of the results of the valuation model which is currently the subject of doctoral research.

The increasing overburdening of the Planet's limited productive capacity is a fact and this raises the question not so much if but when the Cost of Planet will be recognized as an additional investment criterion within shareholder value thinking.