



Ethical Business

How a new breed of business is changing the world

nef has identified a group of Ethical Pioneers that is redefining business for the twenty-first century.

We believe these businesses hold the key to a sustainable future, by transforming markets and delivering positive social and environmental change.

Our new programme of work will explore and promote these ethical pioneers.

nef is setting out to identify the potential of these Pioneers in meeting the great challenges of our times, including climate change and global inequality. This group of Ethical Pioneers is moving beyond Corporate Social Responsibility (CSR) to place social and environmental objectives at the core of their missions and business practices.

nef's programme will examine the business models and practices of the Ethical Pioneers, and explore the challenges they face. The programme has begun by focusing on barriers to success, governance models and financing with a view to evaluating the potential of the Pioneers to change the business landscape. The next stage of the programme will investigate the lessons for traditional businesses and the legal, regulatory and market changes needed to mainstream ethical business.

Ethical Pioneers will provide the insights needed to enable the current generation of ethical businesses thrive in the future and ultimately offer a path to more sustainable ways of doing business - for all businesses.

Dr John Taylor, Programme Director

Ethical Pioneers: putting ethics at the heart of business

nef has identified a group of businesses, the **Ethical Pioneers**, that is unique amongst its peers. These ethical businesses stand out from other businesses in one important regard: they exist to achieve positive impacts on the world around them. This social or environmental *raison d'être* affects every aspect of their business from their operational model and governance structure, to how they manage their supply chains and finance their growth.

Over the past decade, there has been an increasing consciousness of the role that business plays in society. Through trade, employment and the production of goods and services, business is now seen, alongside governments, as a potential agent for creating a sustainable future. Many businesses have responded with Corporate Social Responsibility (CSR) programmes that largely aim to minimise businesses' impacts on society and the environment. Yet CSR, though achieving some positive impacts, cannot solve the major problems facing our environment, society and economy.

Unlike most businesses, Ethical Pioneers don't just exist to deliver returns to their shareholders. Instead,

they seek to tackle the big issues, such as, climate change, in new and innovative ways through creating and capitalising on commercial opportunities. Yet despite a handful of well-known Ethical Pioneers, like Cafédirect and Triodos Bank, little is known about who they are, their objectives, how they do business and their full market potential.

Making business ethical

In an initial scoping survey, **nef** identified three broad business objectives of Ethical Pioneers that we describe as the three P's of ethical businesses: purpose, production, and power.

- **Purpose.** Ethical Pioneers exist to deliver a social or environmental objective and do not operate solely to achieve financial bottom lines.
- **Production.** Ethical Pioneers aim to alter the way goods and services are traditionally produced, and find innovative ways to tackle a problem, for example, by providing environmentally friendly products or employing groups that are socially excluded.
- **Power.** Many Ethical Pioneers see their stakeholders as integral to the success of their business and have adopted governance and new

ownership structures that empower their stakeholders.

In summary, by seeking to apply the three P's, the Pioneers take a **holistic approach** by ensuring that their businesses and activities, whether through governance structures, supply chain management or employment practices, match their values.

"All suppliers and distributors must understand the unique selling points for our product and the reasons for using a naturally renewable resource."

solarcentury - Melanie Davies



What motivates the Pioneers?

The Ethical Pioneers identified by **nef** are businesses that are motivated by a problem, for example, degradation of the natural environment, and are addressing it in an entrepreneurial and profitable way.

Natural environment

Degradation of the natural environment caused by intensive use of non-sustainable resources and over-consumption and waste, are amongst the biggest threats to the long-term health of society, the planet and the economy. Ethical Pioneers work to tackle these issues in a number of ways:

- Exploring renewable fuels.
- Working to reduce environmental footprints.
- Supplying sustainable materials, for example, for building and manufacturing.

Ethical Pioneers are innovating to achieve environmental sustainability whilst competing in mainstream commercial markets.

“When sourcing suppliers we try to stick with those that are like minded.”

Poverty

Despite a five-fold increase in the size of the global economy between 1950 and 1998, over half of the world's population lives on less than two dollars per day. Systemic poverty is exacerbated in parts of the developing world by low commodity prices and international trading practices that undermine the ability of countries to develop their own viable local

economies. Ethical Pioneers play a role in alleviating some of these effects by trading with developing world farmers and paying above-market prices for their goods, while at the same time helping to build local capacity and improving living conditions.

Social change

Social exclusion in the UK remains an endemic problem, with issues such as unemployment amongst disadvantaged groups, child poverty and homelessness continuing to hinder people's ability to achieve their full potential, while putting a strain on economic and social systems. Ethical Pioneers play important roles in delivering social change by providing opportunities for those people who are often excluded by the system. Examples might include providing quality training and employment for at-risk groups, or directly offering goods and services to the socially excluded, such as finance or access to affordable childcare for low-income families.

Defining success and raising the stakes

nef has undertaken an initial scoping survey to discover more about the Pioneers, their successes and the challenges to their growth. What we found was that not only are the Pioneers working in every sector, they are delivering alternatives to mainstream market propositions and redefining what is meant by successful business. However, important questions remain:

- Are the Pioneers just a temporary 'blip' in their markets somewhat



concerned with doing good but waiting to be subsumed by larger players?

- Are they on the brink of breaking through to become the standard bearers for others, raising the stakes and showing the way?
- Will the ethical 'minnows' become the ethical 'mammoths' of the future?

Market presence

nef's initial survey found that the majority of the Ethical Pioneers are small and medium-sized enterprises (SMEs). However, many are growing and over half have turnovers exceeding £1 million with a few having turnovers greater than £25 million. Of these over 90 per cent are profitable, demonstrating that it is possible to combine commercial viability with clear social and environmental goals.

Although ethics seems to be high profile today, the Pioneers are not

solarcentury: pioneering alternative energy

solarcentury, a company that provides alternative energy solutions is one of the fastest growing businesses in the UK, with a five-year growth rate of 8,000 per cent. According to the company, its mission is to revolutionise the solar market. As it clearly states, it is in business for a purpose: “to help create a cleaner world and a sustainable future.”

Founded in 1998, the company designs, supplies and installs solar electric systems. It employs forty people and had a turnover of £2.8 million in the year ending 2003. solarcentury sits on the cutting edge of its industry, tapping into the emerging market for renewable energy. Unlike other competitors in the field, it operates independently of the fossil fuel industry, a world first. British Petroleum, for example, now owns 13 per cent of solar production worldwide.

The company has ten key principles that embody its ethical pioneering ethos, including a commitment to environmental and social justice, a transparent and open governance structure, and trading links with suppliers who share its goals. solarcentury aims to become the world's number one solar solutions company and support the fight against global warming, believing that sustainable development can be achieved within a generation.

You can find more information at www.solarcentury.co.uk.

simply jumping on an emerging trend: over half of the respondents had been in business for more than six years, while one third had been around for over ten years.

“Our objective is to grow exponentially by merging with similar organisations to create a market leading position.”

Minnows or mammoths

Many of the Pioneers are ‘ethical minnows’ competing in markets dominated by large corporations. Whether they can or should become ‘ethical mammoths’ is a key enquiry of this research programme. Can they grow and maintain their ethical stance at the same time? We will look at existing examples including: Yeo Valley Yoghurt, the Body Shop and Ben & Jerry’s.

Taking on the challenge

Practising ethics isn’t always smooth sailing. Starting and growing an Ethical Pioneer can feel like taking on all of the challenges facing a normal business with one hand tied behind your back. This may be one of the reasons why the Ethical Pioneers remain a small proportion of the business population.

nef’s scoping survey teased out the key challenges facing the Ethical Pioneers in their quest for growth:

- **Ethics can be expensive:** The potential higher costs of doing business often put them at a competitive disadvantage with customers.
- **Creating community:** Ethical businesses need ethical suppliers. Finding the right suppliers that embody their ethical principles isn’t always easy.
- **Where are the workers?** Attracting appropriately skilled employees motivated by ethical objectives, possibly compromising on salary levels is an inevitable challenge for the Pioneers.
- **Regulatory realities:** Working within current legislation and regulation

Ethical Pioneers are everywhere:

Construction: Providing environmentally sustainable building materials and innovative techniques that reduce waste.

Agriculture: Organic food is the fastest growing area in the ethical business sector.

Electricity, gas and water supply: With new government targets for renewable energy, and increased awareness of climate change, Ethical Pioneers offer innovative and viable solutions.

Wholesale and retail: Ethical shops are still few and far between, but products being offered by the wholesale and retail sector are on the increase on the high street. Organic, fairtrade and recycled fashion are a new and emerging area for the Ethical Pioneers.

Manufacturing: A high ethical standard on environmental or labour standards in manufacturing everything from computers to pencils.

Hotels and restaurants: Pioneers in the hospitality industry are achieving social purposes, for example, through providing work for disadvantaged groups, or profit sharing with workers.

Health and social work: Providing health care and support for those without access to basic services and housing.

Finance: Providing commercial lending for other ethical businesses, offering green investments through mortgages or ISAs, and increasing financial access for the financially excluded.

Transport: Green transport using alternative fuels is being sourced by local authorities and individuals alike.

may hinder the competitive positions of the Pioneers.

- **Minnows in the ocean:** Threats from big businesses that can keep costs low with marketing budgets that dwarf those of the minnows.
- **Communicating ethics:** Building the market for customers who may be price sensitive, fickle and hard to reach.

“We are at the forefront of the market and this means we have to educate the public, lobby for government support and invest in the fast-changing future.”

“An environmental alternative is higher cost than the mineral fibres widely available in the marketplace and there are limited sustainable merchants throughout the UK.”

Many of these are the same barriers faced by most small start-up businesses, but the Ethical Pioneers don’t necessarily want to work with the same rule book. Many are seeking to carve out a different way of doing business, while still achieving commercial viability.

nef has identified two particular issues facing the Pioneers:

- Ownership and governance structures.
- Access to finance.

The ownership and governance challenge: running business ethically

The twentieth century saw the huge growth in the joint-stock-owned enterprise, with shareholders now the primary owners and governors of business, and the PLC the dominant institution. In the twenty-first century, the role of Company Directors is to ensure businesses are run in the interests of the shareholders. However, the Ethical Pioneers are not primarily motivated by creating

Cafédirect: Raising equity the ethical way

Cafédirect was founded in 1991 by Twin Trading, Equal Exchange, Oxfam and Traidraft, and has since become a household name through sales of gourmet coffees, speciality teas and drinking chocolate. The company's primary aim is to give small producers in the developing world a better deal for their crops and ensure greater opportunities for their communities. Cafédirect's success has seen it grow to a turnover of £17.3 million in 2004.

After making initial equity investments, the founders injected further equity in the form of preference shares and shareholder loans as the company attempted to secure external funding for growth. Yet because of the company's lack of assets, it failed to secure additional debt to its overdraft and revolving credit facilities. Cafédirect's Board explored the possibility of venture capital as a solution, but some of the founders were concerned about the emphasis on commercial returns. In 2003, the company decided to raise capital through a public share issue in order to invest in its brand, develop its presence in various markets, repay borrowings, fund working capital, and invest in computer systems.

Cafédirect raised £5 million in a share issue in 2004 with sponsorship from Triodos Bank. The share issue was oversubscribed. The company's shares will not be listed on any exchange but buyers and sellers will be linked up through Ethex, a matched bargain system run by Triodos. This share issue caught the imagination of over 4,300 individual investors who were willing to invest money in a company that explicitly put its social goals ahead of straight profit maximisation.

Written by **nef** for the Social Enterprise Coalition's publication *Unlocking the Potential: A guide to finance for social enterprises*.

shareholder value. The unique business objectives of the Pioneers have far-reaching implications for their ownership structures and governance, including more stakeholder-based governance methods and new forms of joint ownership with communities and workers. Traditional governance structures may be inappropriate for managing the potentially competing imperatives of social and environmental objectives, and commercial success.

nef will be addressing the following questions to provide insights into the ownership and governance challenge:

- How can organisations maintain their ethical principles and objectives as they grow?
- Do governance structures present limits to growth? Are there additional costs involved in running an ethical pioneer derived from their governance structures?
- What are the ownership structures of the Ethical Pioneers and which promise to deliver the most in terms of fulfilling ethical objectives?

“Our governance model is alien and incomprehensible to business advisors so we have to learn how to develop and improve it from scratch.”

- How do the Pioneers 'govern' trade-offs, and in whose interest, for example, between additional profits and achieving a particular social objective?
- What models have been most successful to date? To what extent does the industry sector determine appropriate governance and ownership?
- Do we need new legal forms of the company to fit the Ethical Pioneers' objectives? Can the dominant shareholder model of ownership deliver positive change?

“We face a lack of accessible finance – and get offered terrible deals.”

The capital challenge: finance for ethical business

Many start ups and small businesses face difficulties in accessing the capital they need to grow. The reality for ethical businesses is compounded by the struggle to find investors who will invest on terms compatible with their social mission. Traditional finance, with its focus on the bottom line and financial returns is often ill-suited for the needs of ethical businesses. **nef**'s research shows that this lack of appropriate finance is one of the biggest barriers to the long-term growth of ethical businesses. Partly as a result of this, many Ethical Pioneers

prefer to grow from cash flow rather than from outside finance.

“What we need is stronger government policy on renewables and 'green' purchasing. We also need greater pressure on the construction industry to encourage innovation.”

As part of the ethical business programme, **nef** is undertaking research to examine the capital challenges facing ethical businesses.

Through this work we aim to answer a number of questions:

- What are the particular issues that ethical businesses face in raising finance? How do these issues differ from mainstream business?
- What types of finance are appropriate for ethical business?
- What barriers exist to being able to offer these types of finance?
- Is the shareholder model of ownership inappropriate for financing ethical business?
- How can a fully functioning social equity capital market be created for ethical businesses?
- How can investors be incentivised to rethink the risk/reward relationship in their investments and value the social return that ethical businesses provide?

Ethical Pioneers the next step

nef believes that the Ethical Pioneers will be fundamental to delivering a sustainable society in the twenty-first century. The Pioneers promise to offer important lessons for large mainstream businesses including on corporate governance, alternative financing models, modes of production and supply chain management.

Our initial focus of research will be on Ethical Pioneers in three key industry sectors: **energy**, **agriculture** and **finance**. These sectors have been selected because they are fundamental to addressing the big challenges of our times. The energy sector deals with both climate change and sustainable consumption; the agricultural sector addresses everything from environmental sustainability and economic well-being, to poverty and food security; and the finance sector underpins the ability of the ethical pioneers to have more of an impact and achieve their goals.

The work programme is guided by several key questions:

- How do we define success for Ethical Pioneers? Is achieving greater market share the main goal, or do they wish to be standard bearers for others?
- What are the challenges facing the Ethical Pioneers? How can they achieve success? Do they need the "big guys" or can they go it alone, with a little support?
- Do Ethical Pioneers need greater



In 1989 a loan from Triodos Bank allowed Komedia to convert a Tesco supermarket into a modern arts venue. Ten years on, and with continued support from Triodos, the venue continues to thrive and grow.

scale or is it more likely that there will be a proliferation of small Pioneers in certain markets, spurring greater levels of competition?

- Do the Pioneers offer an alternative to the shareholder model of business ownership that delivers better social and environmental outcomes?
- What is the role of government in promoting the Ethical Pioneers whether through tax incentives, procurement or changing regulations? Is there a need for more or better policies to support the Pioneers?

In keeping with the **nef** approach, the ethical business programme is research and advocacy based. We not only need to understand what a sustainable future might look like, we also need to make sure we get there.

There is still a long way to go to bring many of the businesses into the mainstream. But the Ethical Pioneers are tenacious, and the idea of doing business any other way than ethically is an anathema. **nef** hopes this programme of work will provide the insights needed to see them thrive in the future and offer a path to more sustainable ways of doing business for all businesses.

Contact

For more information, or to become involved in **nef**'s work on ethical business, either as a partner, supporter or ethical pioneer please contact Dr John Taylor, Programme Director (telephone 0207 820 6364 or john.taylor@neweconomics.org).

nef is a 'think-and-do' tank that inspires and demonstrates real economic well-being. We aim to improve quality of life by promoting innovative solutions that challenge mainstream thinking on economic, environment and social issues. We work in partnership and put people and the planet first.

nef is a pioneer of ethical business and value-led enterprise. This new programme builds on our history. **nef** pioneered social and environmental auditing in the early 1990s **nef** has led research on ethical consumerism, inner-city business and community finance, and is the UK's most visible policy advocate for maintaining alternative business models, such as mutuals, or stimulating the creation of new ones, such as the Community Interest Company. In recognition of our achievements and innovations, **nef** was awarded Think Tank of the Year 2002/3 and continues to be at the forefront of shaping a sustainable future.

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**Thanks to The Hadley Trust for
generously supporting this work.**

Registered charity number 1055254
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