



## The Capitalism We Need

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We live in a highly capitalistic society and many will argue that it has served us well so far. And they are right. It has been a great engine of prosperity for most. We have seen spectacular progress in standard of living, health and education, and also significant reductions in poverty, mortality rates and labour hardship.

So why should business leaders take the risk to re-visit a system that has been so beneficial for shareholders and society? And why now? Unfortunately, shortcomings are becoming more apparent with possibly catastrophic consequences. One of the flaws is the fact that the system has no breaks when it comes to environmental damage and to limits of the use of natural resources.

### Pressing Challenges for Humanity

First, human activity has become such a global force of change over nature that we threaten to overwhelm the world as we know it. The entire Earth system, its physical and ecological processes upon which we depend, is at risk. Based on scientific research, the Stockholm Resilience Institute has identified the nine planetary boundaries that need urgent attention: climate change, stratospheric ozone depletion, ocean acidification, interference with the global nitrogen and phosphorus cycles, land use changes, global freshwater use, rate of biodiversity loss, aerosol loading in the atmosphere, and chemical pollution.

The first signs that “something isn’t quite right” are becoming apparent: more frequent

and extreme weather events, floods, droughts, changes in rainfall patterns, shifting seasons affecting agriculture, changes in wind patterns, sea level rise. These events affect the economy, and companies are beginning to experience serious disruptions to their supply chains, face productivity losses, while their insurance premiums increase.

Secondly, we are the first generation to recognise that humanity is threatening the Earth’s capacity to support our own prosperity. We are currently switching off our life support machine. And we know it. This new insight represents a great responsibility, and the moral obligation to act.

Thirdly, it takes time to overcome barriers to change. Understandably, there is strong psychological resistance, incredible inertia in institutions, business practices and entrenched mind-sets.

Finally, the current economic model is based on continuous growth. To fuel this growth, companies need natural resources, most of which are finite. Some examples include land, water, rare earth elements, and the atmosphere. Moreover, many of these non-renewable resources are irreversibly transformed into goods and services, leading ultimately to their depletion.

Humanity is at a critical cross road: either we embrace a transformation of our society, or we follow a path towards the end for humanity. Nothing less. And since we can’t increase the size of our planet, we have to review its economic model. Given the scale and urgency of the issue, simply “Doing good” or “Giving back to society” is no longer appropriate.

### A Necessary Evolution

There is no reason to be fatalistic. We have created the societal conditions we live in and

we have the power to change it. The capitalism we need is one that manages the 'Commons' so that it does not become a tragedy. We need a system that secures the 'safe operating space of Earth's ecological processes', upon which humanity depends.

### **Business Has to Lead**

There are two reasons for businesses to assume leadership roles.

First, businesses have vested interest in politically and socially stable environments in order to minimise the risks and costs of doing business. However, this desired state is threatened by the reasons given above, and compounded by the rise in income inequalities that lead to social tensions, conflicts, and possibly wars to secure food, energy, water and land. International governance may not be able to deliver the required leadership and national governments may be too concerned with the next election.

Secondly, business has, collectively, the technology and innovation capabilities to address most of the environmental challenges. The key issue, however, is how those solutions can be scaled up. That's where more collaboration is required. On carbon capture and storage (CCS) for example, forming partnerships to build synergies with CCS-focused organisations, engaging with major funding mechanisms such as the Global Climate Fund, and engaging with policy makers could all be ways to join forces to accelerate CCS' development and implementation.

### **A New Type of Leadership**

To support and promote the evolution of capitalism, we need different types of business leaders - people who understand how to combine short term performance with long term interest. Paul Polman, CEO of Unilever, made the decision not to give quarterly profit and loss reports. Such a concrete measure may influence 'short-termism'. It is also better aligned with investment cycles, their returns, and attract long term investors to the company.

Finally, we need people who have the ability to work in more transparent and effective ways in collaboration with others. Leaders who understand the strategic importance of sustainability to their business and see the opportunities rather than the costs.

Company directors' requirement to exercise "due care" must lead them to request CEOs and senior management to look at sustainability from a value creation perspective, rather than from a perspective of philanthropy or simple corporate social responsibility (CSR). The way CSR is practiced is often simply too disconnected from business realities. Peter Bakker, President of the WBCSD<sup>1</sup>, even went as far as to say at the recent World Cities Summit: "CSR is dead".

### **The Journey towards True Cost, True Profit and True Value: Accounting for Externalities**

In economic terms, an externality is the cost or benefit to one party that results from an activity of another party without there being any compensation. The haze, CO<sub>2</sub> emissions or water pollution are examples of negative externalities. Joseph Stiglitz, one of today's most influential economists and recipient of the Nobel Memorial Prize in Economic Sciences states that "Whenever there are externalities (...) markets will not work well."

One of the necessary evolutions of capitalism is to account for externalities in standard business practices. And capital markets need now to enter the discussion and valuation to distinguish good from bad natural capital performance of companies.

This is already ongoing within companies with carbon emissions. Major companies already include a 'shadow carbon price' as a core element in their business strategies. They do this for three reasons:

1. As a business planning tool to help identify revenue opportunities, risks, and cost reductions. It guides capital investment decisions leading to energy efficiencies.

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<sup>1</sup> World Business Council for Sustainable Development

2. Regardless of the current regulatory environment, companies need to prepare for some form of carbon regulations as this will either represent a cost or an opportunity to them.
3. Many companies set internal targets for greenhouse gas (GHG) reductions. A shadow carbon price helps them to evaluate returns on related investments.

On 3<sup>rd</sup> of June 2014, The World Bank Group, together with a growing coalition of governments and major business associations, issued a call to support a price on carbon. The statement will be launched at the UN Climate Summit in New York this September 2014.

### Environmental Profit and Loss

Jochen Zeitz, then CEO of the sports clothing manufacturer Puma, commissioned an Environmental Profit & Loss exercise in 2010. The study found that the potential cost of externalities (including those of its suppliers) was €145m, for a total annual profit of €202m. More than the financial value, the outcome allowed the

management to take better decisions on product design, choice of materials, suppliers, processes and R&D investments.

### The Way Forward

Humanity cannot survive without nature, but nature will definitely survive without us. Companies need enlightened new leaders who quickly take over from those who cannot see the forest for the trees. And a modern form of capitalism has to include the cost of externalities to create a global level playing field. Companies need to collaborate more to develop and use new tools and frameworks that include environmental and social considerations. A great step will be taken when leaders focus more on dependency rather than impact, and on opportunities rather than risks.

We need to reflect on the future we want and our responsibility in it. We still have a choice ... but not for much longer. As Abraham Lincoln put it: "The best way to predict your future is to create it". And the future will need to be sustainable, or we won't have any.<sup>i</sup>

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<sup>i</sup> This article was first published 03 Sept. 2014 in the conference booklet "Towards The New Capitalism", by the Singapore Institute of Directors