The Economist

Unilever

In search of the good business

For the second time in its 120-year history, Unilever is trying to redefine what it means to be a virtuous company

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Unilever's lifebelt

SLEEPING in the open on top of his mansion was a nightly routine for William Lever, founder of what is now Unilever, an Anglo-Dutch consumer-goods giant. When Paul Polman became chief executive of the soap-to-ice-cream-maker in 2009 (joining from a Swiss rival, Nestlé), the Dutchman spent a night in Lever's rooftop bed as part of a total immersion in the history of his new firm. It helped persuade him, a year later, to launch a "Sustainable Living Plan", the name for his attempt to make Unilever the pre-eminent example of how to do capitalism responsibly, just as it had once been under Lever.

Outdoing even the Cadburys of Birmingham and the Rowntrees of York, Lever had pioneered the Victorian model of paternalistic business. At a time when disease and malnutrition were widespread in Britain, his products were marketed for their health benefits. His employees were decently housed in a purpose-built company town, Port Sunlight, on Merseyside. Lever campaigned for state pensions for the elderly and even provided schooling, health care and good wages at palm-oil plantations in the Congo.

"Today, he would do the same things we are doing," says Mr Polman. Like Lever, he insists that running the firm with close attention to its environmental and social impact is not an act of charity but of self-interest, properly conceived. The Sustainable Living Plan aims not only to reduce Unilever's environmental footprint and increase its "positive social impact", but also to double sales and increase long-term profitability. Milton Friedman's view that business should focus on maximising shareholder value has been "interpreted way too narrowly", Mr Polman argues. Under him, Unilever has again become the exemplar of the "good company", the poster child of sustainability. If it cannot make the idea pay—with its deep pockets, long corporate history and determined boss—then perhaps no other firm can.

So far, Mr Polman's efforts have earned rave reviews. A recent survey of "sustainability experts" by GlobeScan, a consultant, ranked Unilever first by a wide margin (see chart). The company is generally reckoned to have the most comprehensive strategy of enlightened capitalism of any global firm.

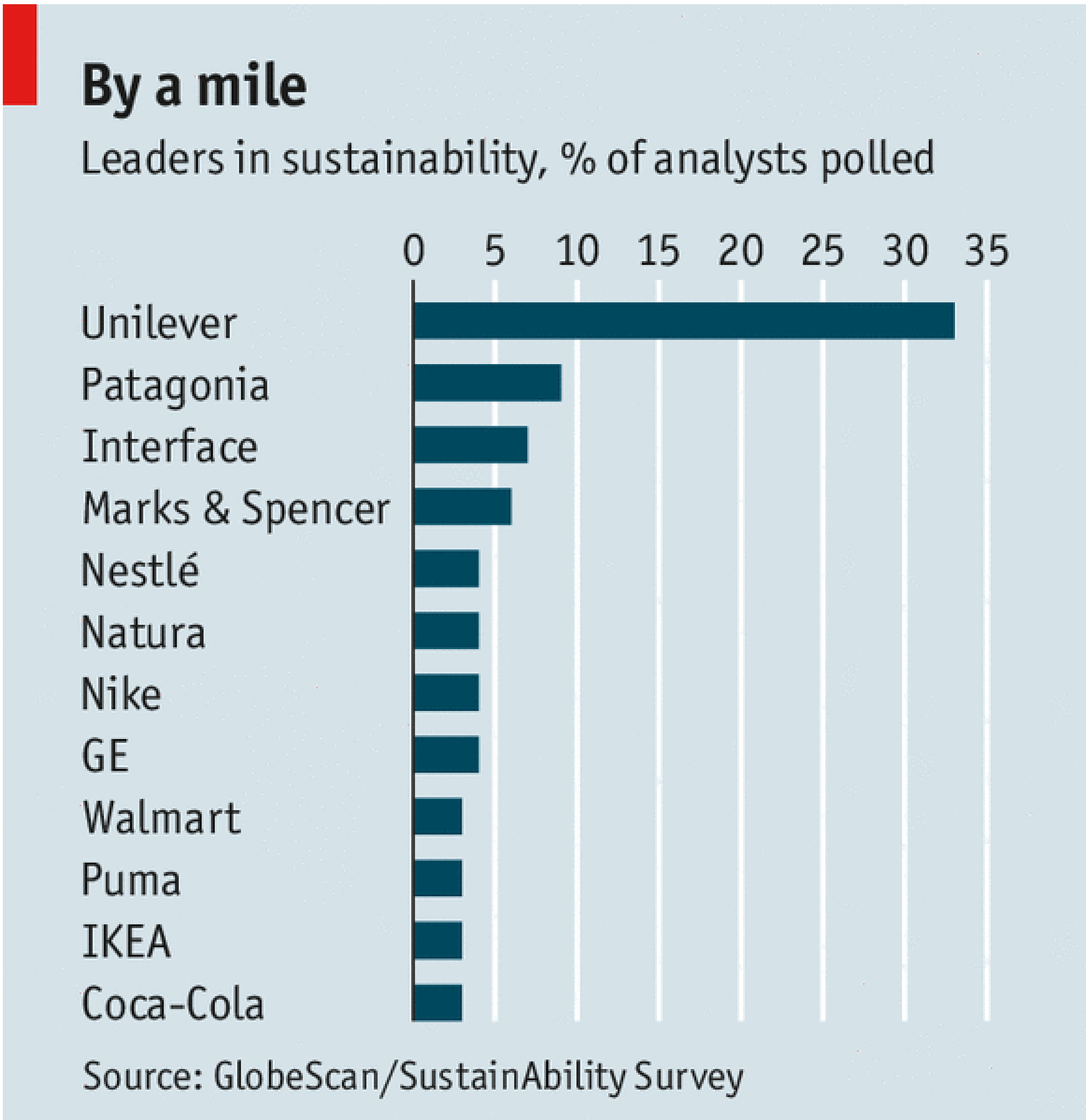
Unilever also stands out for the way it has tried to institutionalise its efforts, says Alice Korngold, author of "A Better World, Inc", a book on corporate do-gooding. The board scrutinises the plan and executive pay is linked to its targets. In March, Mr Polman got a bonus of $722,000 for his efforts. Unilever says the plan has boosted employee satisfaction.

It may also have boosted the share price. Since the plan was unveiled in November 2010, Unilever's shares have risen by more than 40%. And this was during a period when its biggest rival, Procter & Gamble of America, lost its way and ultimately its boss.

But Unilever seems to have reached a critical moment. Its recent annual results disappointed the markets and the share price recently dropped below what it had been a year earlier. Shareholders are cautious. "Unilever has built a strong niche position with investors who focus on environmental [matters]," says Martin Deboo of Jefferies, an investment bank. "But for mainstream investors it is a modest positive at most, and then only so long as it does not cost much." So the big questions are: can the company achieve the targets set out in its sustainability plan? And if it can, will that help it in the long run (as the share-price rise of 2009-2013 suggests)? Or might it eventually cost Unilever dear in terms of market share and investors' backing, as the recent downturn could imply?

The Polman Plan

Unilever defines sustainability broadly. It includes not just environmental factors but improving the lot of customers and workers—its own and those in its supply chain. It also aims to contribute to society as a whole. These goals are seen as necessary to maintain the firm's "licence to operate" in an age when, Mr Polman believes, companies will be subject to increasing public scrutiny.



Specifically, by 2020, Unilever aims to: "help a billion people to take steps to improve their health and well-being"; halve the environmental impact of its products; and source all its agricultural raw materials sustainably, meaning that they should meet requirements covering everything from forest protection to pest control.

Progress on energy use and waste reduction—which the firm directly controls—has been impressive. Through recycling and efficiency drives, three-quarters of Unilever's manufacturing sites now send no non-hazardous waste to landfills. Carbon emissions in its manufacturing operations are one-third lower than in 2008, through a combination of cleaner technologies and greater efficiency. Newly established best practices have spread faster than expected through the company, thanks to the creation of a central corporate team dedicated to spreading the word; previously this had been left to individual factories. The company also set up a "small actions, big differences fund" to invest in cost-saving ideas proposed by its business units.

Many firms do such things. But to meet its broader goals Unilever has to change what goes on beyond its corporate walls. When it measured the greenhouse-gas emissions associated with its products, it found that significant emissions came in the supply chain—ie, not from Unilever itself.

So it had to get the support of its suppliers, who range from food giants such as Cargill to small farmers in India.

In 2010, 14% of its agricultural supplies were sourced sustainably by its own definition. Now the share is 48%. Unilever has achieved this partly by backing its suppliers' innovations. For its soup brand, it created a €1m ($1.3m) Knorr Sustainable Partnership Fund, which invested in schemes such as drip irrigation for tomatoes in Spain and California that have increased yields and reduced water use.

The company has signed up to certification schemes run by the Rainforest Alliance, a non-governmental organisation, to improve farming practices in cocoa (used in its ice-cream brands, such as Wall's and Ben & Jerry's) and tea (used by Lipton's). Rainforest Alliance schemes also have an educational component and Unilever has trained more than half the small farmers of Kenya who grow tea, the country's largest export crop. It has budgeted €4m to expand the scheme to other parts of Africa and to Vietnam. Training small farmers is all the rage with other consumer-goods firms, such as Coca-Cola, SABMiller and Walmart. It improves incomes at the bottom of the pyramid and makes farm supplies more secure by reducing environmental threats such as water scarcity.

Yet although Unilever may be able to buy its own raw materials from sustainable sources, it alone is rarely big enough to make a difference to any given commodity worldwide. As a result, Mr Polman spends a lot of time trying to persuade his peers and rivals to act more sustainably, too. A big test of his effectiveness will come with palm oil, a crop which plays a significant role in deforestation (tropical forests are often cleared illegally to make way for palm-oil plantations).

Polman looks over his shoulder at Lever

Lever's main concern had been working conditions in his plantations. Mr Polman wants to change the entire industry. He and others have persuaded members of the Consumer Goods Forum, an industry group, to sign an agreement to shift to sustainable palm-oil production practices. In July Wilmar, the world's biggest palm-oil trader, signed up—a step forward. But the agreement has been criticised by environmental groups such as Greenpeace for allowing too long a transition to sustainability. Worse, the big Western consumer-goods companies account for only 20% of palm-oil sales (the rest are by local traders in emerging markets such as China). So even if they all promise not to use palm oil from cleared forests, they may not be able to stop the deforestation.

There is a bigger challenge for the Sustainable Living Plan: it will not be possible to meet its goals without changing customers' behaviour. Three years ago the company measured the carbon footprint of 2,000 products and found that on average 68% of greenhouse-gas emissions in their life cycles occurred only after they got into the hands of consumers, mostly through the energy-intensive process of heating water (eg, for tea bags or washing powder).

Changing people's behaviour is hard. The firm has a target of getting 200m consumers by 2015 to take shorter showers (thus reducing greenhouse-gas emissions, saving water—and using more Unilever products designed to work with less liquid). The goal will be missed so badly that people in the company liken it to getting smokers to quit.

The firm has had some success designing products that use fewer resources. Two years ago, for example, it launched "dry shampoo", a powder that works by being combed through hair. It has caught on fast.

But even altering the product does not necessarily lead consumers to change behaviour, so Unilever has embarked on the hardest part of its new strategy—overhauling how it markets its brands. Soon after Lever launched Lifebuoy soap in the 1890s, he started running linked advertisements and educational campaigns. In America, millions of children took part in a Clean Hands Health Campaign in the 1920s. In 2002 Unilever started pushing the same idea in India, offering hand-washing classes in villages. Mr Polman has expanded this across the developing world. "We have done more hand-washing work in the past four years than in the previous 20," he brags. The 21-day course, according to independent studies, reduces diarrhoea cases by 25% and increases school attendance because children are sick less often. The challenge now is to do the same with brands that do not have such obvious benefits as Lifebuoy.

Saving the world one investor at a time

"Unilever is taking this approach [sustainability] further than other companies," says Linda Scott of Oxford University's Said Business School. But refocusing 400 brands "on the good the product can do", she reckons, will take a long time and "require patient capital". And that raises the biggest question of all: will investors give Mr Polman the time he needs?

In the 1920s shareholder pressure eventually forced Lever to scale back his ambitions. Mr Polman has been canny. One of the first things he did after taking over Unilever was to move away from quarterly reporting and stop giving guidance to the markets about the firm's next results. He is trying instead to encourage investors to think about the fundamentals of the business which, he claims, are improved by the sustainability plan.

Still, the share price has been edging lower, and a Unilever executive concedes privately that it may require a crisis—such as a spike in food prices like the one in 2007-08—for investors properly to value the new approach. Mr Polman's experiment in enlightened capitalism is nothing if not ambitious. And not the least ambitious part of it is the attempt to change the short-term horizons of investors.

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