Schumpeter | The parable of St Paul

Unilever is the world's biggest experiment in corporate do-gooding

PAUL POLMAN runs Europe's seventh-most valuable company, Unilever, worth $176bn, but he is not a typical big cheese. A Dutchman who once considered becoming a priest, he believes that selling shampoo around the world can be a higher calling and detests the Anglo-Saxon doctrine of shareholder primacy, which holds that a firm's chief purpose is to enrich its owners. Instead Mr Polman preaches that companies should be run "sustainably"—by investing, paying staff fairly, and by making healthy products with as little damage as possible to the environment. This is actually better for profits in the long run, he argues: society and shareholders need not be in conflict.

Mr Polman's beliefs were tested in February when Unilever received a bid from Kraft-Heinz, a ketchup-to-hot dog gorilla controlled by Warren Buffett and 3G Capital, a fund known for ripping costs out of multinationals. If, in its own mind, Unilever is a good corporate citizen, then it sees Kraft as an angry American with no interest in the planet, heavy debts, no growth, very little foreign presence, and an obsession with self-harming cost cuts.

Kraft's bid fizzled when Mr Buffett got cold feet, but the clash of ideologies is not over. For one thing, Unilever seems to have been pressured into adopting some 3G-style tactics. In April it promised to lift operating margins by 3.6 percentage points by 2020, to carry out a share buy-back and to exit its poorly performing margarine business. Its investment in brands and plant and equipment is expected to be flat in 2017, having risen in former years.

After a "cooling off" spell required by British takeover rules, Kraft can now bid again. Inspired by 3G, activist hedge funds are stalking two rivals, Nestlé and Danone, and other peers are slashing costs. Mr Polman will probably stand down within two years—he wants his successor to be a Unilever insider—raising the question of whether his vision is coherent and will endure.

There are two key tests. Has Unilever really been socially virtuous while creating lots of value for its owners? And does the market for corporate control function as it should, so that such a firm can survive? Start with the question of virtue. Since early 2009, when Mr Polman took over, emissions, water usage and waste have fallen by 43%, 38% and 96% respectively, per unit of production. Investment (including capital spending, research, branding and marketing) has risen to 20% of sales, from 18%. Tax payments have risen from 25% to 30% of underlying profits.

So far so good. But Mr Polman has not been as nice to staff as you might expect. Their numbers have stayed at 170,000 (Kraft meanwhile has cut its workforce by 20% since 2013) but pay as a share of the firm's output, or its "gross-value-added", has fallen from 46% to 39%. Unilever's pay per employee has been flat in dollar terms even as its top few managers have got 24% more on average. Mr Polman received $9m last year, a third more than his predecessor got (though less than his American peers).

He argues that sustainability is good for shareholders because investment creates growth. Consumers, staff and regulators are attracted to firms that exhibit good conduct. For shareholders the clearest sign of success is Unilever's global market share, which has risen from 16% to 18% since 2008, according to Alliance Bernstein, a brokerage. That is impressive given that local firms are gaining ground from multinationals in the emerging economies where Unilever makes almost two-thirds of its sales.

But currency weakness has been a drag. Free cashflow per share has risen by 65% in dollar terms—a fairly average performance compared with a basket of ten Unilever rivals. Total return (share price appreciation plus dividends) was 138% in 2008-16 in dollars, behind the average for the peer group, although not by much. Mr Polman's boldest claims about his firm are over the top, but broadly speaking Unilever has been run in a fairly sustainable way and delivered reasonable results for its owners.

What about the second question—whether such a firm can survive with a fragmented base of shareholders, some of whom may be out for a fast buck? Takeovers should happen only when the target is badly run or if combining two firms will yield synergies. But Unilever is well managed and Kraft's probable changes—more debt, and cost-cutting—it can do itself.

Kraft is a "roll-up", a firm that relies on acquisitions and cost cuts to mask low growth. Its sales have declined for the past nine quarters. Roll-up strategies usually end badly for investors. Still, cheap debt means that, while such firms remain on a winning streak, they can operate on a vastly greater scale than before (a combined Kraft-Unilever might have had as much as $120bn of debt). Many bosses, including, probably, Mr Polman, think normal firms need protecting from them. Britain could adjust its takeover rules in favour of target companies. More countries could alter their fiscal codes to stop tax breaks for leveraged buyers or they could copy France's "Florange" law, which limits the voting rights of short-term shareholders.

Society v shareholder value

In fact, Unilever's close encounter with Kraft suggests the jury is still out on whether capitalism is too myopic to allow firms to operate virtuously. The outcome so far broadly shows that markets work. Unilever's shares were undervalued. Some of the changes that it has made were actually in the pipeline anyway (for example, in 2016 Mr Polman said margins would rise by up to 3.2 percentage points by 2020). Kraft's bid forced the company to fine-tune its strategy and articulate it better. As a result Unilever's total return is now almost at the top of its peer group.

But much depends on the next 24 months. Kraft could bid again. An activist may attack Unilever. Mr Polman's successor could repudiate his approach. Mr Polman is no saint, but his legacy is to have made one of Europe's biggest companies a test case of how far shareholder primacy should go. If Unilever can't keep half an eye on the greater good, no firm can. Watch it closely. ■