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Farm Animal Welfare as an Investment Issue

Summary

Farm animal welfare is an increasingly important issue for companies across all sectors of the food industry – be they retailers, service companies, manufacturers, processors or producers. This has been driven by a range of factors, including regulation, consumer concern, pressure from animal welfare organisations on food business companies and their investors, retailers expecting their suppliers to comply with corporate responsibility policies, and the brand and market opportunities for companies that adopt higher farm animal welfare standards.

Yet, despite these drivers, farm animal welfare as a management issue is relatively immature. While some of the more progressive farm animal welfare NGOs have worked with companies to raise awareness and develop appropriate practices and tools, there is still a lack of consensus around how companies should manage farm animal welfare-related issues.

Investors are starting to play a more active role as they begin to recognise such issues may represent potential financial risks and opportunities for companies they invest in. A number of ethical (screened) retail funds – such as those in the UK and USA – explicitly consider farm animal welfare issues, and some investors have started to engage with companies to improve their performance and reporting on farm animal welfare. NGOs are beginning to engage with investors and it is possible that this will, over time, result in investors paying more attention to the quality of companies' management of farm animal welfare issues which, in turn, should contribute to improved practices on the ground.

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Introduction

Farm animal welfare is increasingly recognised as an important business issue for companies across the food industry – retailers, service companies, manufacturers, processors and producers. Various factors have contributed to this including:

- A tightening of farm animal welfare-related regulation (in particular within the EU)¹;
- Growing consumer awareness of, and concern about, animal welfare issues and the provenance of food in the supply chain;
- The need to respond to supplier expectations and demands (e.g. the pressure on food producers to meet the corporate responsibility (CR) standards of the retailers that they supply);
- The risks to brand and reputation of being 'named and shamed' in high profile media campaigns or food scares/scandals over alleged poor farm animal welfare practices;
- The potential for companies to improve their operational efficiency, margins and profits through reduced wastage;
- The opportunity to access new markets and customers and to grow existing markets as a result of adopting higher welfare standards² ahead of competitors (i.e. first mover advantage).

While the business case for adopting good animal welfare practices would seem reasonably clear, it is probably fair to say that, to date, most investors have paid relatively little explicit proactive attention to farm animal welfare matters, other than in situations where a particular company has hit the headlines for particularly poor or controversial practices. This is slowly starting to change as investors see that farm animal welfare can be a core business issue, not just an occasional controversy for companies in the food industry, as the costs and benefits of good and poor performance become clear, and as clients and NGOs start to ask

¹ For an overview of European farm animal welfare legislation, see Peter Stevenson (2011), 'Farm Animal Welfare: The Regulatory and Policy Landscape. Business Benchmark on Farm Animal Welfare – Investor Briefing No. 1'. http://www.bbfaw.com/wp-content/uploads/2010/08/regulatory_landscape_oct_2011.pdf

² For a wider discussion of the business case for action on farm animal welfare, see Katy Read (2011), 'Farm Animal Welfare: The Business Case for Action. Business Benchmark on Farm Animal Welfare – Investor Briefing No. 2 (October 2011)'. http://www.bbfaw.com/wp-content/uploads/2010/08/business_case_for_action_oct_2011.pdf

questions about how farm animal welfare issues are being taken into account in investment decisions³.

Within this context of farm animal welfare issues starting to receive greater investor attention, the aim of this briefing note is three-fold. The first is to explain how investors look at non-financial, or environmental, social and governance (ESG), issues in general in their investment processes. The second is to analyse how they approach and consider farm animal welfare issues, and the obstacles faced in making farm animal welfare a more 'mainstream' investment issue. The third is to explore and consider how the debate is likely to evolve over time.

How do investors take environmental, social and governance (ESG) issues into account in their investment processes?⁴

Before considering the specific case of farm animal welfare, it is useful to first explain why and how investors take account of environmental, social and governance (ESG) issues in their investment processes.

There are various reasons why investors may want to pay attention to ESG issues. Apart from the ethical arguments, it is increasingly recognised that good ESG practice and processes increase the likelihood of business success (e.g. through better downside risk management, identifying cost savings, identifying business opportunities). Thus, explicitly and proactively evaluating how companies manage ESG issues could potentially help identify hidden business risks and opportunities not necessarily uncovered by conventional financial analysis (e.g. obtaining insights into the quality of a company's approach to risk management). The other major reasons for investors to pay attention to ESG issues is that they are facing demands from key stakeholders such as clients (pension funds, individual investors etc.), the media and NGOs to play a more active 'ownership' role in the companies in which they are invested.

There are a number of different approaches that investors can use to take account of ESG issues in their investment processes and activities (see Table 1). These centre either on the company's products and services (i.e. what they do) or how they operate (e.g. their corporate responsibility or 'CR') practices. These approaches can range from 'traditional' negative screening approaches (i.e. where companies are avoided/excluded from investment as a result of their practices, their products or their activities) through to the more recent and popular approaches of engagement and enhanced analysis that have emerged over the past ten years⁴.

³ These drivers were identified by participants in the investment analyst briefing on farm animal welfare convened by UKSIF, together with Compassion in World Farming and the World Society for the Protection of Animals, on 11 October 2011 in London.

⁴ For a recent assessment of the prevalence of these different strategies in Europe, see Eurosif (2010), *European SRI Study* (Eurosif, Paris).

Table 1: Overview of Common Investment Strategies that take account of ESG Factors

Strategy	Description
Negative screening	Avoiding (i.e. not investing in) companies on the basis of their products, the sectors they are in, the activities they carry out or their specific management practices.
Positive screening	Preferentially investing in companies on the basis of their products, the sectors they are in, the activities they carry out or their specific management practices.
Best in class	Preferentially investing in companies with better governance and management processes and/or with better environmental or social performance.
Positive/thematic investment	Selecting companies on the basis of their exposure to themes such as climate change or demographic change, or their involvement in a positive area e.g. renewable energy.
Engagement/activism	Using the formal rights (e.g. the ability to vote via shareholdings, the ability to call an emergency general meeting) and informal influence available to investors to encourage companies to improve their management systems, their performance or their reporting.
Integrated analysis (or enhanced analysis)	Proactively considering environmental and social factors in 'mainstream' investment research and decision-making.

When we look at farm animal welfare issues, a similar typology of approaches can be applied. That is, investors could decide to exclude companies based on the nature of its product involvement (e.g. does not produce organic food), and/or whose farm animal welfare practices are considered unacceptable (e.g. houses chickens in barren battery cages); preferentially invest in companies with better practices; engage with companies to encourage them to improve their approach to farm animal welfare; or build farm animal welfare issues into their investment decisions. The approach (or approaches) an investor decides to take will vary on a case by case basis, depending on a number of factors such as the significance of the exposure (e.g. the percentage of a company's sales derived from the product/activity in question); the size and profile of the company in question (e.g. is it a large or a small player in the industry, which could determine how likely it is to face media attention), the geographical exposure of the company and associated risk exposure, the in-house resources of the investor and so on.

Are farm animal welfare issues currently on investors' agenda?

Relative to other ESG investment issues, such as climate change or human rights, farm animal welfare, at least to date, has been relatively neglected in the investment community. So far, there have been relatively few examples of investor engagement with companies on farm animal welfare issues, with most being reactive (e.g. in response to press stories). Moreover, where there has been some focus, this has not necessarily been on farm animal welfare *per se* but on related issues such as the accuracy of labelling and marketing claims or the public health and safety implications of the farmed product (examples have included the use of growth hormones, salmonella and BSE).

Even among those fund managers managing ethical or screened (retail) funds, farm animal welfare has received relatively little attention, and certainly much less attention than other animal welfare related issues such as whether the company provides animal testing services, whether the company tests its products on animals, or whether the company is involved in the production or marketing of fur products. Where farm animal issues are explicitly considered, they are generally expressed in terms of whether the company derives sales from intensive farming (i.e. the screen relates to intensive farming in the round rather than specific practices), whether the company is involved in animal slaughter (again, without reference to the specific practices in the company's facilities) or whether the company sells significant amounts of meat (without any consideration of the provenance of these products)⁵.

Examples of investor engagement with companies on animal welfare related issues⁶:

Dean Foods (US) & product organic labelling

- Over the period 2005-2007, a coalition of US SRI investors engaged with Dean Foods over its claim that its Horizon milk products were organic, despite operating factory farming conditions.
- Concerned about the brand/reputation implications, investors filed shareholder resolutions requesting the board address the issue.
- As a result of the company's unconstructive response to investor and public concern, a consumer boycott was called resulting in some food retailers ceasing to stock the company's product.

Tesco and poultry welfare

- During 2008, the UK food retailer faced a media campaign, launched by a celebrity chef, alleging that its poultry welfare practices were not in line with its animal

⁵ We would like to thank Mairead Hancock and Lisa Hayles (EIRIS), Reinhilde Weidacher (Ethix SRI Advisers) and Jennifer Kozak (Aviva) for the information they provided on these issues. There are a number of databases that provide information on the animal welfare (and other) criteria used in ethical funds; see http://www.ethicalinvestors.co.uk/fund_directory.php and <http://www.yourethicalmoney.org/investments/> (for UK funds), and <http://www.socialfunds.com/funds/chart.cgi?sfChartId=Social+Issues> (for US funds).

⁶ We would like to thank a number of UK and US investors for sharing company engagement examples, some of which have featured in this note.

welfare and corporate responsibility policies. Unusually for the UK, a shareholder resolution was put forward against the company.

- The campaign explicitly and proactively sought investor support for the resolution and succeeded in gaining some sizeable support, including a number of large institutional investors.
- Although the resolution was not passed, it did result in the company addressing the issue more responsibly and due to the company's leading market position, led to greater awareness of animal welfare issues across the UK food industry.

Kellogg's (US) & caged eggs

- Co-operative Asset Management has engaged with Kellogg's in relation to its use of intensive animal farming systems, specifically battery cages, and the potential damage to its reputation that this may cause. Co-operative Asset Management has asked Kellogg's to commit to procuring all of its eggs from cage-free sources within a reasonable timeframe⁷.

There are several reasons why farm animal welfare issues have received limited attention from investors, at least to date:

- The common perception that animal welfare is primarily an ethical issue rather than being underpinned by a robust business case.
- Animal welfare is seen as something of a niche issue relevant only to companies in the food industry, as compared to, for example, climate change and water, which are seen as relevant to many sectors.
- A general lack of familiarity in the investment industry of farm animal welfare issues, in terms of the technical aspects and associated standards. This is compounded by the fact that there are multiple species and multiple geographies involved, and there is no clear consensus about the specific expectations of companies⁸. This lack of consensus makes it difficult for investors to identify clear aims and objectives when engaging with companies and, taken with the complexity of farm animal welfare issues, has resulted in investor being unwilling to engage with companies on this issue.
- A lack of publicly available information on how companies manage farm animal welfare issues, which makes it difficult for all stakeholders to differentiate between those companies that do a good job and those that do not.

⁷ See, further, Co-operative Asset Management (2011), *Responsible Investments Quarterly Review, Autumn 2011* (Co-operative Asset Management, Manchester).

⁸ The importance of achieving consensus around the specific expectations of companies as a critical factor in ensuring the effectiveness of investor engagement was a central conclusion from Oxfam's Better Returns in a Better World project (see, further, Helena Vines Fiestas, Rory Sullivan and Rachel Crossley (2010), *Better Returns in a Better World. Responsible Investment: Overcoming the Barriers and Seeing the Returns* (Oxfam, Oxford)).

- A lack of evaluation tools to enable investors and others to assess and benchmark the relative performance of companies.
- The perceived inevitable need for intensive farming practices in light of the need to feed ever growing global populations, with many investors assuming that some compromise of animal welfare standards is probably inevitable to address this need.
- The perception that higher welfare animal farming practices result in higher financial costs for companies.

While some of these factors are more significant than others, none is insurmountable. However, they suggest that a significant amount of work is required to raise investor awareness of farm animal welfare, to develop consensus on what 'good practice' looks like, to explain how the tensions and perceived trade-offs can be addressed, and to produce information that enables investors to meaningfully assess how individual companies are managing farm animal welfare issues.

What does the future hold with regards to investor's animal welfare issues?

There are some signs that investors are beginning to pay greater attention to farm animal welfare issues than has been the case in the past⁹, although the reality is that animal welfare will most likely remain somewhat of a specialist issue relative to other ESG issues. Drivers for this stem from upcoming regulation and labelling requirements (in particular within the EU), growing widespread consumer willingness to pay a premium for higher welfare farm produce, scares and scandals (e.g. in the UK, salmonella in eggs, BSE and beef, and in the US and the EU, concerns about growth hormones), the greater availability of higher quality information and media/NGOs campaigns (recent examples include iconic brands such as McDonalds and KFC) and as the issue gets interwoven with other ESG issues such as climate change and water availability.

In the short to medium term, it is likely that we will see developments in three areas:

- **How animal welfare issues are framed and viewed:** While some investors will continue to take a predominantly ethical stance to tackling animal welfare issues, it is likely a greater proportion of investors will come to recognise the business case, particularly when viewed in the context of wider business issues such as food quality and safety, marketing ethics and associated litigation risks, and wider environmental and agricultural challenges. As such, it may become more of an explicit focus area for responsible investors. Improvements in the quality of information and engagement by NGOs will play an important part in raising investor awareness and understanding.

⁹ A number of the attendees at the UKSIF-convened seminar in October 2011 (see Note 3) commented that they were starting to look more closely at farm animal welfare-related issues when analysing food companies.

- **Demand for greater public transparency about company management and performance:** Investors are likely to engage with companies to encourage improved reporting on farm animal welfare, in order to provide investors with reassurance that this issue is being effectively managed, where it is considered business relevant.
- **Greater scope for integration of the issue into investment decisions:** Investors, if appropriate information and tools are available, will begin to differentiate between companies on their management of and performance on farm welfare issues (either as an issue in and of itself, or as a more general proxy for quality of management). If the experience with other ESG issues is repeated, it is likely that early efforts will seek to differentiate between companies on the basis of the quality and completeness of their management reporting but, over time, greater attention is likely to be paid to performance.

Opinion: Compassion in World Farming and the World Society for the Protection of Animals

Compassion in World Farming and the World Society for the Protection of Animals are working together on a programme of engagement and dialogue with investors, with the aim of increasing investor awareness of farm animal welfare. There are various reasons for us to focus on investors: the positive influence that investors can exert on companies, the importance of ensuring that individuals can invest in line with their ethical objectives, and the reality that farm animal welfare is an issue that investors need to be aware of and that they need to ensure is effectively managed by the companies in which they invest.

We recognise that farm animal welfare is a relatively new issue for investors and we acknowledge many of the arguments set out in this briefing about why farm animal welfare has not, to date, been a major issue for investors. We have much to do to educate the investment industry, to raise the awareness of farm animal welfare, and to ensure that investors have the tools and information that they need to do their job effectively.

In the short term, we will be focusing our attention on improving reporting and developing tools that enable investors to differentiate between companies. We will share this information and these tools and will encourage investors to use them and to explain to us how farm animal welfare issues are being included in their investment processes and decisions. We hope that, over time, we will see investors playing a much more proactive and supportive role in advancing the farm animal welfare agenda.

Concluding comments

Farm animal welfare is, at present, something of a niche issue for investors. However, all the signs are that it will become less niche and that we are at a tipping point – regulation is tightening, the costs of poor performance are becoming clear and NGOs are starting to focus on the role that investors can play in encouraging higher standards of farm animal welfare.

While it is clear that investors can, and will be expected to, play a role in encouraging higher standards of farm animal welfare across the food industry, meeting these expectations will first require that there is consensus on what good practice on farm animal welfare looks like and that companies provide the information necessary to enable their farm animal welfare performance to be assessed.

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The **Business Benchmark on Farm Animal Welfare** is designed to help drive higher farm animal welfare standards in the world's leading food businesses. It is the first global measure of animal welfare standards in food companies and is designed for use by investors, companies, NGOs and other interested stakeholders.

For more information, go to www.bbfaw.com or contact the Project Director, Nicky Amos: nicky@nicky-amos.co.uk.