

ESG Spotlight.

Food Waste – Are the food retailers acting responsibly?

When Pope Francis declared last year that “throwing away food is like stealing from the table of those who are poor and hungry”, he was highlighting a significant global issue.



Contribution by Angeli Benham –
Corporate Governance Manager

Angeli is a corporate governance manager responsible for voting and engagement on ESG issues.

She joined LGIM in 2005, having previously gained over 10 years experience in corporate governance.

In the UK alone, £12bn of food is thrown away by households each year, the equivalent of £470 per household. Yet, despite being the world’s seventh wealthiest nation, the UK is facing its own food poverty. Although the case for reducing food wastage centres on the consumer, there is a lot that food retailers can do too.

The success of the big four food retailers – Tesco, Asda, Morrisons and Sainsbury’s – has been built on offering consumers range and scale. Now three trends are changing this. First, customers want the right food at the right price, meaning that bombarding shoppers with special offers for food that they do not want is no longer a sustainable strategy. Second, customers who are more interested in scale have been defecting to the likes of Aldi or Lidl at a steady rate. Aldi and Lidl currently have a market share of around 8% in the UK, which is projected to grow to a natural ceiling of 15-20%. Third, shopping habits are changing, with consumers making more, smaller visits to convenience stores, as well as using online shopping services, rather than going and doing a single large weekly shop. These three factors are combining to hit profitability at the big food retailers.

IS FOOD WASTE AN INVESTOR ISSUE?

At LGIM, we believe that companies that demonstrate good corporate governance and have sustainable business policies will usually generate superior financial returns for their shareholders. Furthermore, effective stewardship benefits companies, investors and the economy as a whole. (UK Stewardship Code, FRC September 2012).

LGIM supports the Stewardship Code and is a long-term investor in multiple asset classes with £476.8bn of assets under management (as at 30 September 2014). A significant proportion of these assets are in index tracking strategies, but whatever the underlying investment strategy, we are active owners. We expect all companies in our ownership universe to behave responsibly and ensure they build a sustainable business model which promotes the highest ethical standards. We believe that good corporate governance practices go hand-in-hand with sustainable long-term value creation.

As an active investor in food retailers and food producers listed in the FTSE, we want to ensure that these companies are addressing the risks associated with food waste which can have an adverse impact on their business model.

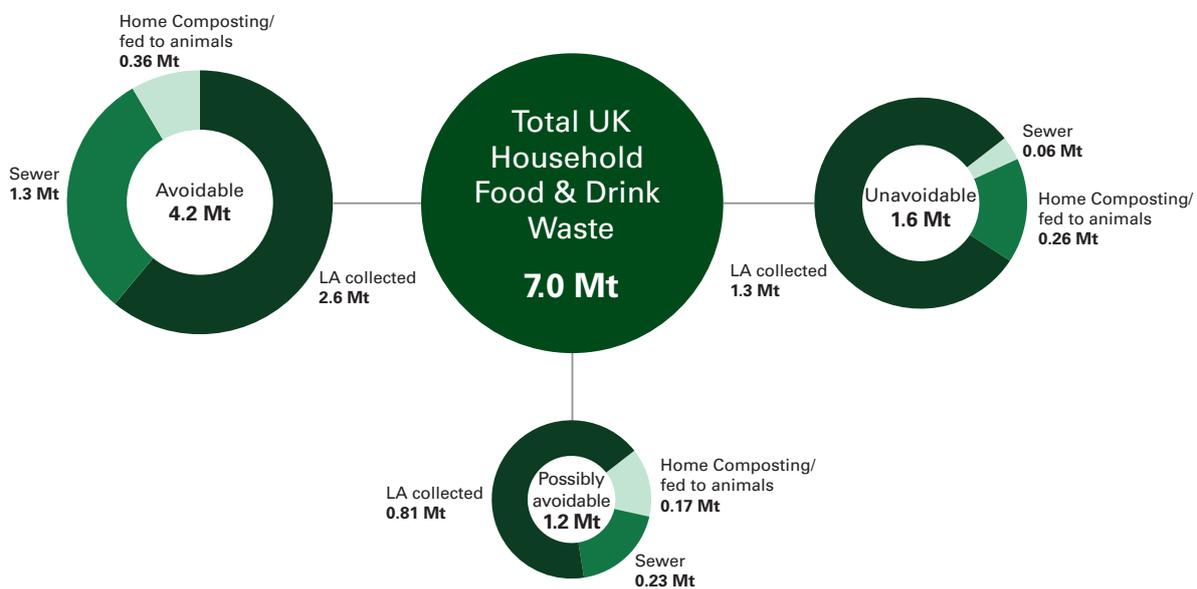
This report was written primarily to draw attention to the on-going risks associated with food waste and to encourage retailers and food producers to continue to invest in tackling waste. Moreover, it also highlights the diversity of issues that LGIM raises with its investee companies.

WHY IS FOOD WASTE CONSIDERED A PROBLEM?

According to the Waste and Resource Action Programme (WRAP), a not-for-profit organisation looking at UK resource efficiency, in the UK, we threw away seven million tonnes of food waste in 2012 – more than 50% of which could have been eaten. This is equivalent to six meals per week for the average UK household. Furthermore, reducing this waste would dramatically decrease CO2 emissions – in fact it would be equivalent to taking one car in five off the road¹.

This is not a UK phenomenon either: measured on a global scale the amount of waste increases to 1.6 billion tonnes², which is tragic given that there are 825m people around the World who do not have enough to eat. Despite being the 7th wealthiest nation in the World, the UK is facing its own food poverty, with charities providing food parcels for up to 500,000 families a year.

Figure 1: Total UK household food and drink waste



Source: WRAP: Household Food and drink waste in the United Kingdom 2012

We believe that food retailers are the key link in the chain. Research suggests that around half of all waste occurs at the consumer level, and a material proportion of waste occurs before it reaches their warehouses. However, their size and contact with the different ends of the supply chain gives food retailers a unique ability to help both groups reduce waste.

DO UK FOOD RETAILERS CONSIDER THIS AS A RISK?

LGIM has met with Tesco, Sainsbury's, Morrisons and Marks & Spencer (M&S) to discuss how they were tackling this issue. All four have identified food waste as a societal and environmental risk and have taken steps to limit their own impacts. To date, only Tesco has taken the step of publishing its own food waste data. Other companies were a little reluctant to disclose this level of information at the time of the meetings. However, a number of them have agreed to disclose this information from 2015. We think disclosure of the scale of the problem is an important step in addressing the associated risks. Measurement is key in determining whether policies are delivering desired reductions in waste.

WHY DO WE CARE AS AN INVESTOR?

Food waste is a consideration for all shareholders as it impacts shareholder value.

- Security of supply can lead to higher input costs for the retailer which can impact margins and their ability to compete in the current environment.
- Loss of revenue can lead to lower profitability, lower share price and dividends.
- Losses within the stores/warehouses will incur additional expense both in terms of loss of revenue and disposal costs.
- Too much focus on driving volume by using bulk purchase tactics can result in loss of customer loyalty and revenue.

¹Household food and drink waste in the UK: 2012 report' www.wrap.org.uk

²Food and Agriculture Organization of the United Nations. Food Wastage Footprint: Impacts on Natural Resources www.fao.org

Looking beyond the direct impact, the water used in producing the wasted food increases the risk of future water shortages and increases the risk of higher costs in the years to follow. Water scarcity impacts more than just the food and beverage industry, industries such as mining are also heavy users of water.

- It takes 12 litres of water to produce just one tomato.
- 650 litres of water to produce one chicken breast.
- A portion of rice uses 125 litres of water
- A loaf of bread takes a whopping 1,200 litres to be produced.
- On average the amount of water needed to produce food is about 1000 times the weight of the food itself.

Each year, food that is produced but not eaten uses a volume of water equivalent to the annual flow of Russia's Volga River or three times the volume of Lake Geneva.

As water scarcity is likely to become a bigger issue over the next decade, we are actively engaging with companies to limit water wastage and increase awareness, which we believe would help change behaviour.

WHERE DOES WASTE BEGIN?

Many factors can contribute to waste at the farming stage in the supply chain. Whether farms are located in developed or emerging countries can have a big impact, as emerging economies can suffer from inefficiencies and technological limitations. Other factors that contribute to waste include over-supply, climate change, or volatile weather patterns that can lead to damage or disease. Poor storage facilities and conditions can lead to shorter shelf life and can increase the possibility of pest infestations, leading to further waste. Despite the higher potential for losses, retailers continue to source from emerging regions due to the lower costs per unit of produce.

WHAT ARE THE RETAILERS DOING TO HELP THEIR SUPPLIERS?

Tesco

Tesco collated data from across its global supply chain to help understand the key drivers of waste. Some of the steps they have taken include offering longer-term contracts and guaranteeing a proportion of the order. This gives suppliers more security, allowing them to invest more on driving efficiencies through technological innovation. Dealing directly with the suppliers reduces the need for storage and increases freshness. Specifications are kept as wide as possible: Tesco has different ranges – from value through to Tesco's Finest – and can therefore absorb lower quality produce and limit waste. Mis-shapen produce can also be utilised in other paths such as processing fruit and vegetables for juice.

Sainsbury's

Sainsbury's has invested £8m in research and development to help farmers to operate more efficiently. Forums have been established to help suppliers share good practice. It has also introduced a closed loop system, whereby they place an anaerobic digestion system next to the farm. Any waste from the farm goes straight for anaerobic digestion and the energy produced is used by the farm with any surplus directed for use by Sainsbury's. It is also giving longer-term contracts to its farmers, typically two to three years. Guarantees have been offered to dairy farmers to take all of their milk. Sainsbury's also has a basics range for produce that does not meet with its strict guidelines.

Morrisons

Morrisons has more control over waste than its peers as it has its own abattoirs and manufacturing plants, and can therefore adjust production based on sales forecasts. Any produce that does not meet guidelines on shape and size can either be sold as part of its value range or distributed to manufacturing sites to be used in ready meals. On occasion, where climatic pressure has caused difficulties with some crops they have relaxed their specifications. They have relaxed their terms of trade with their own label suppliers so that products that cannot be sold in store can be distributed to organisations such as Company Shop/Community Shop, Fareshare and His Church. Morrisons has also worked closely with suppliers on packaging innovation which has increased the shelf life of products.

M&S

M&S has invested heavily on IT systems to improve forecasting and allocations. Studies have been carried out on 50 products to see what can be done to improve shelf life; at most this has increased the shelf life by a day. A university fund has been set up for equipment manufacturers to bid for pilot projects. A digital hub allows their suppliers to dial-in and share case studies to help improve their processes.

CAN RETAILERS INFLUENCE CONSUMER WASTE?

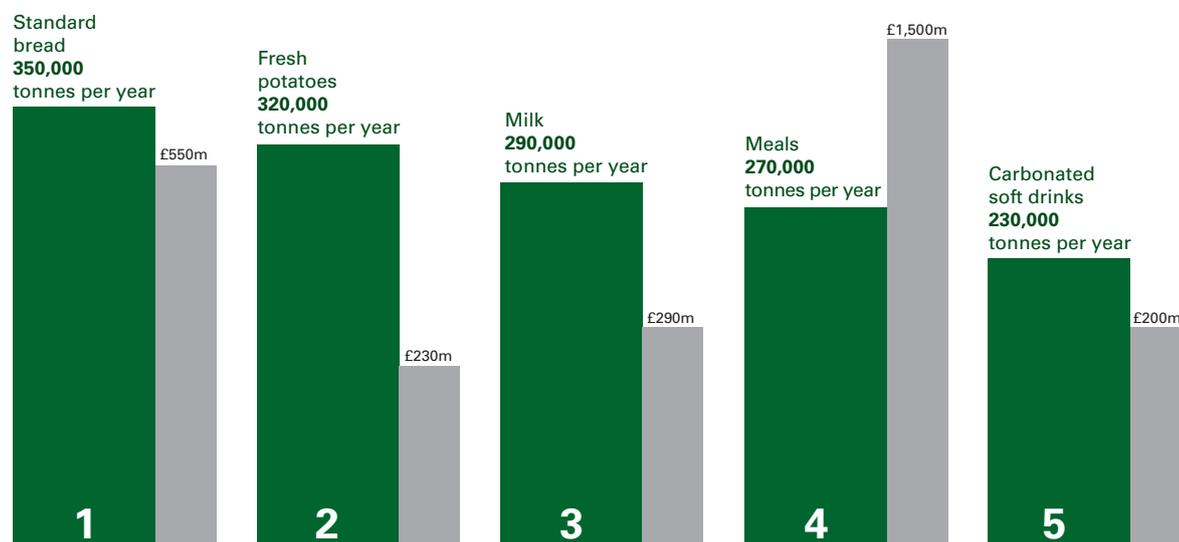
The Department for Environment, Food and Rural Affairs conducted a review of waste policy in England in 2011 and set out commitments to create a path to a zero waste economy. It is also working with WRAP and businesses to create voluntary agreements to reduce food and packaging waste. A prime example of this is the Courtauld Commitment – a voluntary agreement aimed at improving resource efficiency and reducing waste within the UK grocery sector.

Although WRAP noted a slight reduction in waste when they carried out their analysis in 2012, the waste was still equivalent to £470 per household. The food retailers we spoke to have introduced initiatives to help their customers reduce waste.

However, at the same time their focus on volume sales and brand-led offers such as ‘buy one get one free’ can lead to more waste. Family-sized packs or bulk purchases appear to provide better value, this value can be eroded if the food is not consumed by the use by date.

Figure 2: What food gets binned the most?

The top 5 foods that we waste in our home



Source: WRAP: Household Food and drink waste in the United Kingdom 2012

These sales tactics can have two detrimental impacts – an increase in food waste and loss of customer loyalty when they realise that their savings are eroded by the level of ultimate waste. Improving customer knowledge about storage or what can be frozen can help to reduce this waste. In our view, having this information on the website isn't enough. Clear packaging or labelling or in-store posters near the products should be considered.

Over the past few years, the main four supermarkets have been losing market share as customers are defecting to shops such as Aldi and Lidl. These shops offer cheaper goods without the need to bulk buy. The big four supermarkets may need to encourage shoppers to reduce their waste by offering different sized packs across the entire fresh produce range. These could be offered at a competitive base price per unit rather than encouraging shoppers to buy more than they need by only offering competitive prices on bulk purchases. This will benefit the retailer in winning loyalty and will reduce household waste.

More innovation is required in packaging to increase shelf life and reduce waste. Some of the companies that we spoke to are already investing on improving packaging.

Finding ways to help customers to be more creative with their left-overs will also enhance loyalty. WRAP introduced the Love Food Hate Waste campaign that most of the food retailers have signed up to and provides useful tips for left-overs. We hope to see evidence of supermarkets working closely with WRAP to support their campaign to decrease wastage and increase customer loyalty.

THE FUTURE: MORE COLLABORATION?

Although only a relatively small amount of waste is directly attributable to supermarkets, they enjoy significant influence thanks to their position and power across the entire food chain, from supply chain to customer, which Tesco refers to as 'farm to fork'. Tesco, Sainsbury's, Morrisons and M&S already have programmes in place to reduce waste at the supply chain end of the journey.

There is now more debate about whether food retailers could do more if they worked together. Given the competitive nature of their business, historically, this was impossible. But faced with a growing threat of food security, climate change and the growth of discounters, it might be time to act together for the greater good. By working together they will be able to make better advances in technologies to extend food shelf life, help farmers reduce waste and help consumers to enjoy shopping and reduce waste. By educating their customers and helping them to save money, food retailers will win brand loyalty.

LGIM will continue to engage these companies on food waste policies, their own targets to reduce waste and keep up the pressure for collaborative work that will help to reduce waste. We have seen the benefits of collaborative work within the supply chain in the garment industry, i.e. the Accord/Alliance – which is improving safety of garment workers. We feel there is more that can be done to improve efficiency and reduce waste in the food retail market.

Continuing the dialogue with food retailers, on its own, will not bring about material reductions to food waste. We will engage with DEFRA to find out what more they can do to help reduce food waste. We will explore the option of relaxing some regulations without increasing health and safety concerns, and request more research is carried out into food safety to help with this issue. Only by engaging all stakeholders in the food chain can we stand to reduce food waste and ensure food sustainability for the future generation.

CONTACT US

For any further information on anything you have read in this report or to give us feedback, please email angeli.benham@lgim.com. Please visit our website www.lgim.com/corporategovernance where you will also find more information.

IMPORTANT INFORMATION

Views and opinions expressed herein are as at November 2014 and may change based on market and other conditions. This document is designed for our corporate clients and for the use of professional advisers and agents of Legal & General. No responsibility can be accepted by Legal & General Investment Management or contributors as a result of articles contained in this publication.

The information presented in this document (the "Information") is for information purposes only. The Information is provided "as is" and "as available" and is used at the recipient's own risk. Under no circumstances should the Information be construed as: (i) legal or investment advice; (ii) an endorsement or recommendation to investment in a financial product or service; or (iii) an offer to sell, or a solicitation of an offer to purchase, any securities or other financial instruments.

Legal & General Investment Management, its associates, subsidiaries and group undertakings (collectively, "Legal & General") makes no representation or warranty, express or implied, in connection with the Information and, in particular, regarding its completeness, accuracy, adequacy, suitability or reliability.

Legal & General reserves the right to update this document and any Information contained herein. No assurance can be given to the recipient that this document is the latest version and that Information herein is complete, accurate or up to date.

All rights not expressly granted to the recipient herein are reserved by Legal & General.

© 2015 Legal & General Investment Management Limited. All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means, including photocopying and recording, without the written permission of the publishers.

Legal & General Investment Management Ltd, One Coleman Street, London, EC2R 5AA
www.lgim.com

Authorised and regulated by the Financial Conduct Authority.

M0203