Appendix IX
Two Stories of Value Creation – How Externalisation Drives Mass Impoverishment

***Disclaimer**: Alpha plc and Sir Robin Quickly are fictitious creations. Any similarity to individuals or companies whether UK-based or otherwise is entirely coincidental.*

The Alpha Story

In 1997, Robin Quickly was a young man with a dream. Working with two friends from rented premises in an out-of-town business park, using second-hand IT equipment funded by a loan from his parents and a small government grant, he founded a company which was destined to change the way Britons buy their clothes. In its first year of operation, the then unknown Alpha company had a turnover of just over £300,000 and made a small loss.

Today, Alpha plc is recognised as one of the UK's most dynamic and successful companies. In little over 20 years, it has grown from nothing to a turnover of £1.5 billion, and is still growing at over 10% per annum. Customers love Alpha. Because of its innovative business model, its costs are approximately 5% lower than those of bricks-and-mortar competitors – and it has passed this cost saving on to customers. Its service levels are consistently high. And Alpha was one of the pioneers in using algorithms to drive product selection. It has swept its competition aside.

To provide this efficient and low-cost nationwide service, Alpha employs over 14,000 people and buys from over 200 suppliers. Alpha makes an Operating Profit of £69 million, has hardly any debt and makes a Profit Before Tax of £67 million. Last year, it returned £22 million to shareholders in the form of dividends, and retained £44 million for reinvestment in business growth.

Sir Robin Quickly (he was knighted in 2012 for services to industry) still owns 25% of Alpha, and has been handsomely rewarded for his vision and hard work. Known as 'Mr 10%' both because of his business's stellar growth rate and because his bonus is set at 10% of profit, his combined salary and bonuses amounted to £7 million last year.

This is a story of value creation in which everybody benefits. Almost 10 million customers buy from Alpha every year. Alpha's suppliers receive more than £1 billion in revenue each year. 14,000 predominantly young people, who might otherwise be out of work, have regular employment. The taxpayer benefits directly by £2 million. And shareholders received £22 million as a return on their investment.

The reported figures

Alpha's profit and loss account is shown below.

Figure 61: Alpha's reported Profit and Loss

	Reported values	
Profit and Loss Account	**(£ million)**	
Revenue	1,500	100.0%
Cost of goods for resale	(1,145)	-76.3%
Variable staff cost	(118)	-7.9%
Gross profit	*237*	15.8%
Graduate payroll	(20)	-1.3%
Other payroll	(100)	-6.6%
Government grant income	1	0.1%
Other operating costs	(49)	-3.3%
Operating costs	(168)	-11.2%
Operating profit	*69*	4.6%
Interest	(2)	-0.1%
PBT	*67*	4.5%
Tax	(2)	-0.1%
PAT	***65***	4.4%
Dividends	(22)	-1.5%
Retained Profit	44	2.9%

The true story of Alpha's success

Of Alpha's 14,000 staff, 10,000 (full-time equivalent) are on zero-hours contracts. As they are predominantly young people, they need not be paid the living wage of £7.83 per hour, and are instead paid the minimum wage of £5.90 per hour. Alpha expects – naturally – that they will nevertheless be living, and the difference (£1.93 per hour) is made-up by in-work benefits from the government and, in some cases, support from the parents of the employee.

Of the full-time staff, 1,000 are recent graduates who are paid an average of £10 per hour. Because this is less than the threshold at which they would be expected to repay their student loan (£12.50 per hour), they do not do so. The government absorbs this cost.

Alpha is not carbon-neutral. Although it aims to be environmentally responsible, it believes that CO_2-neutrality is not yet cost-effective and would add 2% to the cost of the supply chain, which would have to be passed-on to customers. These emissions are a significant, though invisible, cost to the rest of society.

These are costs of Alpha's business model which it has managed to externalise – someone else pays for them. They are in effect secret subsidies from society to Alpha's business. Correcting for these subsidies produces a very different Profit and Loss Account.

Figure 62: Alpha's corrected Profit and Loss

Profit and Loss Account	**Number of staff in category**	**Reported values in profit and loss account (£ million)**		**Benefit of subsidies**	**Value in unsubsidised profit and loss account (£ million)**
Revenue		1,500	100.0%	0	1,500
COGS		(1,145)	-76.3%	23	(1,168)
Variable staff cost at minumum wage	10,000	(118)	-7.9%	39	(157)
Gross profit		*237*	15.8%	*61*	*176*
Graduate payroll below threshold	1,000	(20)	-1.3%	5	(25)
Other payroll	3,000	(100)	-6.6%	0	(100)
Government grant income		1	0.1%	1	0
Other operating costs		(49)	-3.3%	0	(49)
			0.0%		
Operating costs		(168)	-11.2%	6	(174)
Operating profit		*69*	4.6%	*67*	*2*
Interest		(2)	-0.1%		(2)
PBT		*67*	4.5%		*0*
Tax		(2)	-0.1%	12	(14) [87]
PAT		***65***	4.4%	***80***	***(14)***
Dividends		(22)	-1.5%		
Retained Profit		44	2.9%		(14)

Without subsidies, Alpha makes a loss of £14m. The rest of society, principally via government, provides £80 million in subsidies, and gets back only £2 million in taxes. Without the subsidies, Alpha would not have a 5% cost advantage over its rivals. It would not have grown at 10% per annum. Its competitors would still be in business. Most of those 14,000 underpaid employees, many on zero-hours contracts, would still

87 The tax treatment is as follows: on the basis of the subsidised profit in the business, Alpha should have paid tax at the standard rate of corporation tax, totalling £14 million. For tax purposes however, the algorithms used by Alpha for product selection are owned by Alpharithm LLC, a Cayman Islands registered company, which charges Alpha just under £57 million to use these algorithms. As a result, Alpha's taxable profit is just £10m and it pays only £2m in taxes, a difference of £12m.

be employed in High Street retail. They would not be well-paid, but they would be paid better than today, and in more secure jobs.

Without that £80 million, Sir Robin Quickly would not be paid £7 million, and his shares would not be worth £300 million. The business would not have £44 million to invest in its growth. And shareholders would not have received £22 million in dividends.

Alpha’s subsidies have massively distorted competition. A bad business (as shown by the corrected profit and loss account) has been able to drive out numerous good businesses.

This is a fictitious example, but it is not unrealistic – and it illustrates how allowing businesses to externalise their costs can distort competition and create an engine of mass impoverishment and environmental destruction.