

Urban Returns - The Value of Corporations for the Community

With the presentation of the recently published study “Urban Returns of the Public Housing Industry”, the Institute of Management at Humboldt -University Berlin breaks new ground, in that it calculates companies’ rates of return with regard to all aspects of society.¹ By implementing the model “Urban Returns” one cannot only consider a company’s immediate fiscal rate of return but also its overall contribution to all societal aspects of a community. Hence, the calculation of “Urban Returns” facilitates for the first time the assessment of the services actually rendered for cities and communities by state-owned and private companies.

The formalisation of the concept of return against the background of the special situation of the public housing industry now enables us to objectify the pros and cons of the public residential trade and industry. The study takes into account the effect of manifestations of corporate social responsibility on public housing companies’ returns and makes it measurable. This applies not only to the effect of these undertakings on corporate performance but also to the effects on society or those supported. This study is a first step towards an objectification of the discussion regarding a comparison of “urban returns” between public and private housing companies.

The Term “Urban Returns” in Public Discussion

The term “Urban Returns” is relatively new. Serious discussion of this subject within the public residential trade and industry started only two years ago. Lutz Freitag, president of GdW (the Federal Association of German Housing and Real Estate Companies (e.V./registered association)) used the term in April 2005, in his “ten theses on urban privatisation” at the 12th annual Handelsblatt conference on the Real Estate Industry. In the sixth thesis, Freitag said:

The increasing requirements of urban development and reconstruction and the accompanying increase in importance of communal housing companies are not taken

1 J. Schwalbach, A. Schwerk and D. Smuda, Stadttrendite der öffentlichen Wohnungswirtschaft. Formalisierung und Operationalisierung des Begriffs ‘Stadttrendite’ und Anwendung am Fallbeispiel DEGEWO (Communal Returns of the Public Housing Industry. Formalisation and operationalisation of the concept “Communal Returns”. Case study DEGEWO), Berlin 2006.

into account in the selling decision. However, especially in this area we can observe a considerable increase of “Urban Returns”. Housing companies gain these “returns” in addition to the fiscal rate of return and the fulfilment of the commitment to supply housing.²

The foundation pillars of “Urban Returns” are based on a long-term observation of the performance of a company and on a set of values that takes into account not only economic but also societal and ecological effects. So far, no practical concepts exist for measuring and calculating “Urban Returns”. These concepts should comprise the objectives of the company observed as well as those of the city or the community in which it operates and which it serves. Only then will we be able to measure and calculate “Urban Returns” and to contrast this figure with the mere financial returns of companies. Therefore, “Urban Returns” expresses the value that a company constitutes for the city or the location in which it operates.

The concept of “Urban Returns” seems to be a completely new one in the area of the housing industry. However, looking more closely one can observe analogies with the discussion regarding so-called “corporate social responsibility” that has been taking place for some time.

“Urban Returns” and Sustainability

For a better classification of the term “Urban Returns” we should first bring to mind the current discussion concerning the so-called corporate social responsibility.

So far, there has been no uniform definition of the term “corporate social responsibility” (CSR) in science and practice. Comprehension is impaired by the fact that apart from CSR there are related terms used synonymously or to emphasize particular aspects. For example, there is a definition of CSR in the Greenbook of the European Commission of 2001:

“By CSR we mean that companies assume social as well as ecological responsibility that goes beyond the respective national legal obligation”. CSR is “...a concept, that provides a basis for companies to integrate social and ecological aspects on a voluntary basis into their corporate activities and their interactions with stakeholders”.

2 Source: http://www.gdw.de/download/12te_Handelsblatt_Jahrestagung08-04-05.pdf

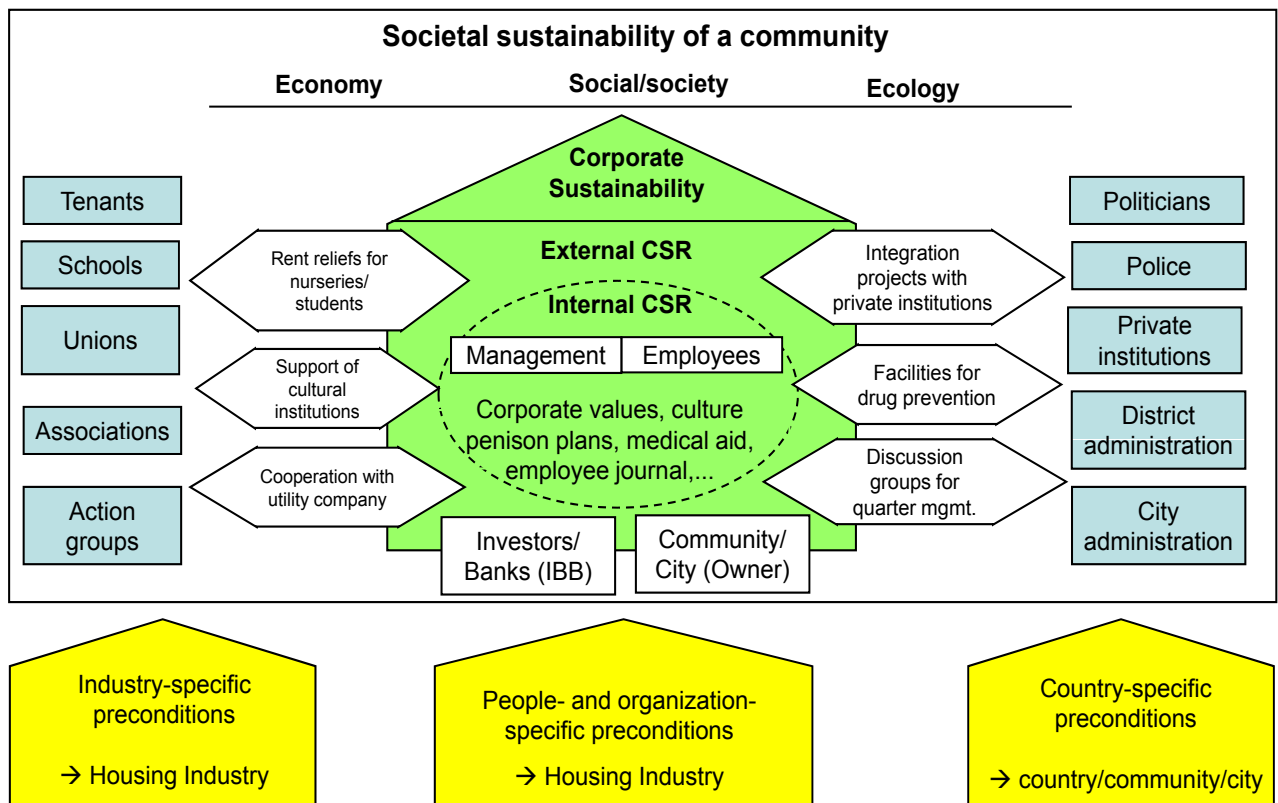


Fig. 1.: Model of Corporate Responsibility adapted for the housing industry

The discussion on enhancing responsibility of companies is based on a series of influencing factors, the most important being:

Cutbacks in government subsidies

A decrease in government spending in the areas of social benefits and education should be compensated by non-government institutions.

Globalisation

To an increasing extent, companies operate worldwide, and are obliged to play a part in the global community, which is affected by different values, cultures and norms.

Information and communication technology

A higher degree of the population's extent of and access to knowledge increases the transparency of corporate activity.

Environmental and Corporate Scandals/Affairs

The way in which the media deal with scandals, such as the poison gas accident in Bhopal and the Enron scandal, have led to an enhanced awareness by the population at large.

"Global Governance"

Offsetting the declining influence and the shrinking governmental competence of national administrations by non-government institutions (e.g. solution to the Aids problem in Africa or the corruption problem in Nigeria and Bangladesh).

Expectations of the Company's Environment

A company's environment is affected by continuously changing and more and more demanding interest groups. Consequently, companies are constantly forced to adjust to changing conditions.

As far as "Urban Returns" in the housing industry are concerned, the most relevant of the influential factors above are "Cutback in Government Subsidies" and "Expectations of the Company's Environment". Recent examples of the cutback of government subsidies are the discontinuation of the *Eigenheimzulage* (federal subvention for private house-builders) or the cessation of the follow-up support in Berlin against the background of the necessary debt reduction of the federal and state budgets.

Today, the environment of state-owned or public companies is influenced by diverging expectations of different interest groups. While in the mid-twentieth century, it was widely agreed that satisfying public interests and therefore the common welfare that was anchored in the bye-laws as a corporate objective was pre-eminent; nowadays some interest groups – though differing in their aims - expect returns on investment (capital) equal to that of private companies.

CSR and therefore the concept of "Urban Returns" contributes to sustainability from which the whole of society benefits and which is based on three fields of responsibility: Economy, Social and Societal aspects, and Ecology.

As can be seen in Figure 1, corporate social responsibility contributes to **corporate sustainability** and consequently to the **sustainable development** of the society as a whole. Thus, the emphasis has to be on long-term instead of short-term profitability and shareholder-value maximisation. The term “sustainable development” follows the definition of the UN Commission in the Brundtland Report (1987): “*Sustainable development is a development which is able to meet today’s demands without interfering with the possibilities of future generations to meet their demands*”.

Companies that place sustainable development in the centre of their business activities follow the so-called stakeholder approach. In the literature, stakeholders of a company are groups or individuals who affect the achievement of the company’s objectives or who are affected (on their part) by the achievement of the company’s objectives. One assumes that not only shareholders – through their property rights – have a vested interest in the company, but also other claimant groups, such as employees, customers, suppliers, non-governmental organisations (NGOs), as well as the local environment at the company’s location.

“Urban Returns” in the Housing Industry

How can the housing industry use the above considerations regarding “Urban Returns”? Figure 1 provides an answer.

Economic responsibility, in combination with the maximisation of shareholder value, is in the centre of private companies. Public companies, however, frequently focus on other objectives beyond pure profit seeking. As an example, this catalogue of objectives is recorded as follows in the statutes of the Berlin-based German Society for the Promotion of Housebuilding (Deutsche Gesellschaft zur Förderung des Wohnungsbaus AG (DEGEWO)):

“The purpose of the company is doing real estate business of any kind, in particular to build and operate lodging for broad levels of the population, including low-income households, at acceptable costs. Unless regulated differently by law, in Berlin the company will conclude lease contracts and calculate rents in a way that allows cost and expense recovery including appropriate returns on equity as well as setting aside reserves. Maintenance and modernisation of flats as well as building new tenements should contribute to Berlin’s urbanistic development and meet the requirements of environment protection.” (§2 of the DEGEWO statutes dated 21st December 2004)

Thus, the statutes of DEGEWO explicitly state social and ecological objectives in addition to economical ones. Hence, the company codifies a corporate policy that is based on long-term alignment with stakeholder interests.

The concept of “Urban Returns” uses the elements of the stakeholder approach and is based on the pillars of economy, ecology and social affairs. Considering returns based on traditional performance figures only would not satisfy the actual efficiency of a housing industry that aims at long-term value added.

Operationalisation of “Urban Returns” for the Housing Industry

The starting point for the operationalisation of “Urban Returns” is the fiscal formula of rate of return: the ratio of financial performance and capital invested (cf. figure 2).

Following our comments above, when calculating “Urban Returns” one has to consider not only economic components but also ecological and social ones. Thus, evaluation of rates of return considers the following three performance categories:

- **direct** profits of the company (financial earnings, e.g. annual surplus).
- **indirect** returns in the form of a company’s costs for projects for the benefit of the community, for which otherwise the local government authority would have had to pay.
- **follow-up** returns in the form of earnings for the community and the company as a result of the investment in community projects.

Figures on **direct** profits are provided by the company’s accounting department. The same applies to **indirect** profits. The latter comprise cost positions which may also be considered returns from expense-avoidance by the local authority. E.g., they may include foregone revenues through the waiving of rental fees in the case of social housing, which are socially desirable but lack managerial justification when short-term shareholder maximisation is involved.

Both the community and the company benefit from the company’s activities by means of so-called **follow-up returns or earnings**. The community and the company realise these returns directly, though they are time-delayed. For the company, the earnings are a result of higher reputation, which for instance, may express the attractiveness of the company as landlord or seller of housing. At the same time, the company’s activities enhance the attractiveness of the community for citizens, investors and tourists.

This is reflected, e.g., in higher tax revenues, an increase in corporate formations, decreasing social spending due to unemployment and positive population growth.

We define the returns based on relatively sound operational data for direct and indirect earnings as “**Urban Returns level 1**”, those based on follow-up returns as “**Urban Returns level 2**”.

Formula for the Calculation of Urban Returns

$$\text{Return on Capital Employed (ROCE)} = \frac{\text{Profit + Taxes + Interest (EBIT)}}{\text{Average capital employed}} \times 100$$

Urban Returns

Profit + efforts of the housing company for long-term economically justified city projects (indicated via respective cost) + returns for the city not covered in the balance sheet resulting from activities of the housing company

X 100

Total capital employed or company value

Fig. 2: Formula for the Calculation of Urban Returns

Case Study: Calculating “Urban Returns” for DEGEWO in Berlin

DEGEWO, together with its subsidiaries Wohnungswirtschaftliche Beteiligungsgesellschaft (GEWOBE, since 1991), Köpenicker Wohnungsgesellschaft mbH (KÖWOGGE, since 1995), and Wohnungsbaugesellschaft Marzahn mbH (WBG Marzahn, since 2002), is Berlin’s biggest public housing company. Founded in 1924, DEGEWO is a Berlin company with a long and proud tradition. Housing estates such as Märkisches Viertel, Gropiusstadt and Schlängenbader Straße (a housing estate built above a motorway) are some of the more famous projects of DEGEWO. The DEGEWO group manages almost 70,000 of its own and third-party flats in Berlin and the Brandenburg outskirts. Business activities of the DEGEWO group comprise letting, managing and planning, maintenance and modernisation of the real estate stock, management for third parties, as well as new developments and project development.

Calculation of “Urban Returns level 1”

DEGEWO has initiated or participated in many “citizen projects” and supports already existing ones. The costs for these projects usually comprise costs for own personnel, payment of parties outside of DEGEWO, lease costs or lost rents as well as miscellaneous costs. These projects should improve the situation of the inhabitants of DEGEWO estates and they fulfil almost all strategic objectives listed in the catalogue of estates management. They are considered “citizen projects” and their costs have to be considered fully when calculating

“Urban Returns level 1” since they satisfy the criteria for a strategic and target-oriented CSR measure.

Promotion and donation activities of the three companies, DEGEWO, KÖWOGGE and WBG Marzahn, show donations of more than 100 different types in the fields of jubilees/openings, culture, children/adolescents, sports, social institutions/handicapped persons, district management, associations/foundations and miscellaneous amounting to 331,000 Euros in the years 2003-2005. In 2004 alone, 131,000 Euros were donated (2005: 84,005 Euros).

Another large block of costs borne by DEGEWO, although they should rather be added to city spending, are the costs for urban tasks, measures for market adjustment and for the acquisition and/or the management of unprofitable quarters and estates. These costs amounted to 8.7 million Euros in 2005.

Rent waiving and deferrals reduce the financial burden of the city and facilitate the acceptance of tenants in household communities or their continuance in stable social environments. In 2005, the value of these rent reductions and waivers amounted to 3 million Euros.

Furthermore, DEGEWO offers reduced rents for students and senior citizens. The students’ discounts amounted to 400,000 Euros in 2005. In addition, DEGEWO provides flats for homeless persons. Last but not least, the city is granted the right to occupancy (i.e. the city may use DEGEWO flats for its own (council) tenants). Without DEGEWO’s above mentioned support, the city would have to bear the costs in order to fulfil its social duty to provide housing for handicapped and underprivileged persons.

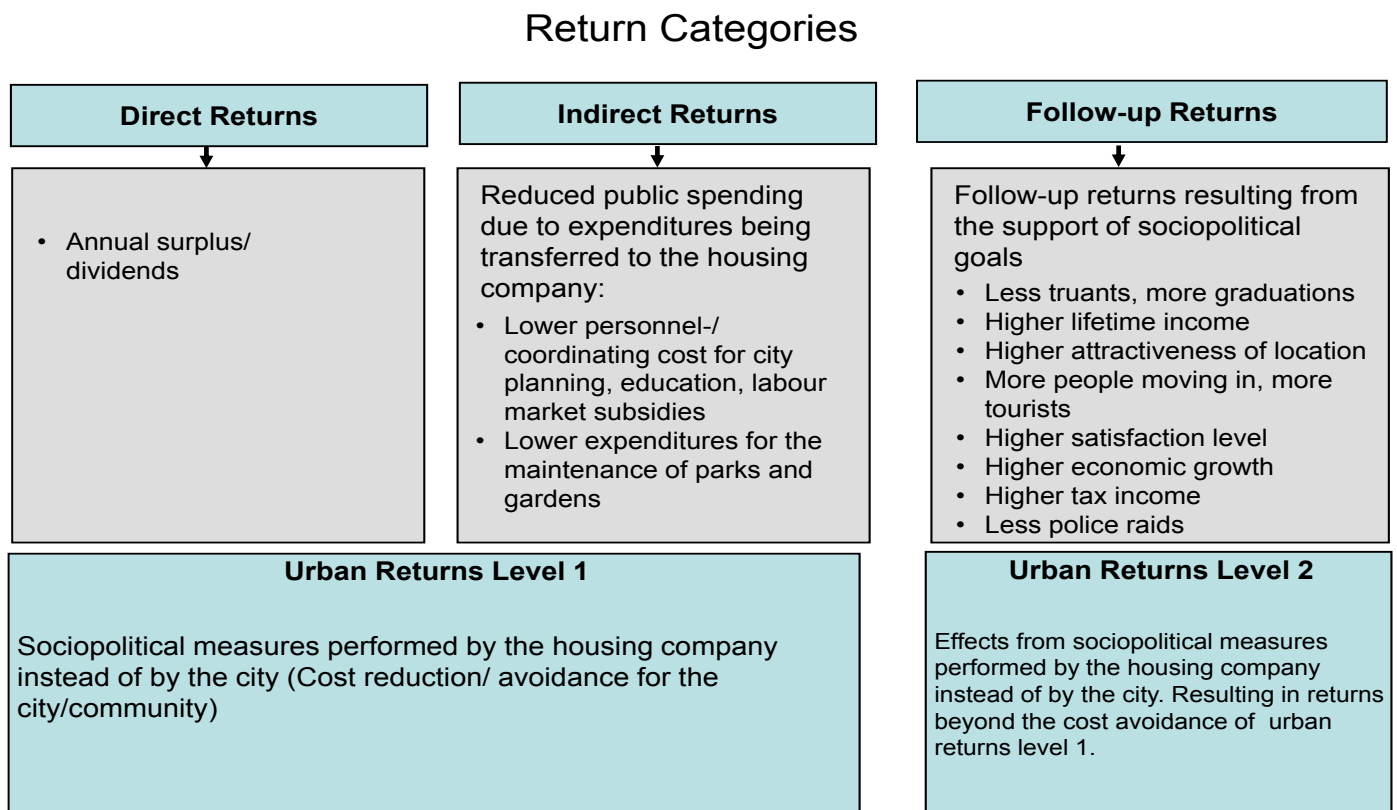


Fig. 3: Direct, indirect and follow-up returns

In 2005, the DEGEWO group realised an annual surplus of 4.1 million Euros. Its contribution to operating income was 17.2 million Euros, which can be used as a basis for calculating “Urban Returns Level 1”.

Calculation of “Urban Returns level 2”

For “Urban Returns level 2” or the follow-up earnings of the city and for DEGEWO, we define seven monetary effects. Since these effects are broadly defined, it is important that the most important (sub)areas are considered. What follows is a short description of the logic of these effects.

Follow-up earnings may be generated by persons, households and/or companies already located in the city (“Berliners”) or by those who are not Berlin residents (“non-Berliners”). DEGEWO undertakings creating additional work places and increasing the qualification of the employees and/or leading to a higher educational achievement increase the city’s gross value-added and the income of the people concerned. We quantify the effects of these activities based on secondary studies and the resulting sum is part of the follow-up earnings.

By moving to Berlin, persons who hitherto were non-residents (“non-Berliners”) may contribute to an increase in municipal earnings through payment of taxes and fees. Since the direct and indirect payments the city receives differ for normal and student households, we also differentiate between these two in our calculation. Of course, the numerous tourists also contribute to

the city’s revenues. According to a study carried out on behalf of the city, part of these revenues go to the community as tax revenue (dwif-Consulting GmbH).

Beside the returns, we also have to consider the avoidance of costs that are a result of DEGEWO activities, but which are not included in the contribution to operating income of “Urban Returns level 1”. This concerns not only prevention costs (such as avoidance of police operations) but also “resolving” costs (e.g. ALG 2 = unemployment compensation, formerly social welfare, by means of which financial hardship due to unemployment should be resolved).

For the calculation of the follow-up returns for “Urban Returns level 2” we have to start with evaluating the unit value for each of the effects described (that is, e.g., taxes and fees the city receives for each member of a household). In a second step, we derive the number or frequency of occurrence (e.g. how many additional households move in, or in how many cases migration out of the city is avoided). The product of value and frequency is the relevant contribution to “Urban Returns level 2”.

Calculation of “Urban Returns levels 1 and 2”

For the calculation of “Urban Returns levels 1 and 2”, direct, indirect and follow-up returns are related to the company’s value. According to financial literature, several methods for the determination of company values may be applied. Following the well-established

methods used in practice, for this study we evaluated not only the equity-based company value but also that based on Discounted Cash Flow (DCF).

The monetarily evaluated effects from estimates of “Urban Returns level 1” amount to 17.2 million Euros (see above) and those of “Urban Returns level 2” to 29.6 million Euros. As a result, DEGEWO activities lead to benefits for the City of Berlin as the company’s owner and as a community amounting to 46.8 million Euros in 2005. On the basis of the DCF-based company value of 582.6 million Euros, we have overall “Urban Returns” (levels 1 and 2) of 8.04%; based on an equity-based company value of 372.5 million Euros, “Urban Returns” amount to an even greater 12.57%.

Conclusion

Companies are increasingly confronted by the problem of how they incorporate CSR in their corporate activities. Triggered by an intensified globalisation of markets, we increasingly expect corporations to assume corporate social responsibility and respective reporting. On an almost daily basis, the media make an issue of positive as well as negative examples of corporate social responsibility. These reports show that many companies pay insufficient attention to the issue of their own social responsibility or that they fail to report. This has negative effects on the company’s reputation and consequently on its performance.

Increasingly, companies accept social tasks in their communities that originally were tasks of the local government authority. However, such town and city councils quite frequently do not, or only insufficiently, evaluate the social contribution of such companies. Consequently, there is a lack of appreciation for the corporate activities, which may have negative effects on the investments made by the companies in their locations. Therefore, both parties, local government and company, should have a vested interest in learning about the “Urban Returns” of their company or companies.

The term “Urban Returns” is new. Discussion of the subject, mainly among members of the housing industry, did not really start until two years ago. This is why we cannot resort to a universally valid definition of “Urban Returns”. In our view, the term “Urban Returns” should comprise the value of a company for the city or community, regardless of the ownership structure of the company. This means one has to consider not only the financial operating results but also the company’s social contribution for the community. In this context, long-term observations are indispensable, since many of the factors affecting “Urban Returns” take effect in the medium- or long-term only.

This study by the Institute of Management of Humboldt University Berlin is a first attempt to compile suitable criteria for measuring “Urban Returns”. Using a

public, state-owned company as an example, the study broaches the issue of the effects of “social” undertakings and activities by companies which benefit the local government authority’s finances, and the community at large. Calculations of “Urban Returns” for a private company are still pending. The method for the calculation of “Urban Returns” presented in this study facilitates the determination and the comparison of social contributions of private and public companies to local government and the community.

The authors:

Joachim Schwalbach, Professor of International Management and Director of the Institute of Management, School of Business and Economics, Humboldt-University Berlin, Spandauer Str. 1, D-10178 Berlin, Germany
Email: schwal@wiwi.hu-berlin.de

Anja Schwerk, Scientific Assistant, Institute of Management, Humboldt-University Berlin
Email: schwerk@wiwi.hu-berlin.de

Daniel Smuda, Tivona Partners, Berlin
Email: daniel.smuda@tivona.de