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**Economics  
of Mutuality**

# Conservatorio

An Economics of Mutuality case study



**Responsible Business Forum: The Economics of Mutuality**

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# Conservatorio



**Contributor**  
**Lionel Khalil**



**Contributor**  
**Keyes  
Christopher  
Hardin**



**Contributor**  
**Judith Stroehle**



**Contributor**  
**Alison McArthur**



**Contributor**  
**Alastair Colin-  
Jones**



**Contributor**  
**Sudhir Rama  
Murthy**



**Contributor**  
**Kwang Kim**

## About the Responsible Business Forum Case Studies

This series of case studies explores how mutual approaches to business can help companies and their partners tackle some of the most pressing global challenges. The businesses featured in this series share a commitment to objectives beyond purely financial performance, as well as a serious intent to implement mutual practices through new forms of ownership, governance, leadership, measurement and management.

In particular, these cases address the measurement of multiple forms of capital, ecosystem shaping approaches, leadership development, business education, and policy formulation through laws and regulation that promote mutual conduct. The authors appreciate the collaboration of participating companies in creating these cases.

These cases were first developed for the annual Responsible Business Forum, the convening event of the Mutuality in Business Project, a joint research programme between Saïd Business School, University of Oxford, and the Catalyst think tank at Mars, Incorporated. The Responsible Business Forum brings together global companies, MBA candidates, scholars and activists to share their experience in confronting key challenges in their ecosystems to generate financial, social and environmental value.

## Authors' Note

The conclusions and recommendations of any Saïd Business School, University of Oxford, publication are solely those of its author(s), and do not reflect the views of the Institution, its management, or its other scholars. These cases are based on information provided to the researchers by participating companies.

## Mutuality in Business

Tel: +44(0)1865 422875

Email: [responsiblebusiness@sbs.ox.ac.uk](mailto:responsiblebusiness@sbs.ox.ac.uk)

Web: [Economics of Mutuality](#)

Web: [Oxford Saïd Mutuality in Business](#)



# CONSERVATORIO

## Sustainable Urban Revitalization

### About Conservatorio

Conservatorio is a real estate development company with over \$250 million (USD) assets under development, co-founded and headed by Keyes Christopher (“K.C.”) Hardin, a U.S. corporate lawyer. Established in 2006, the company is a Certified B-Corp that carries out “sustainable urban revitalization” by building mixed-income, mixed-use (commercial or residential), transit-oriented (i.e., focussed on revitalizaion) projects in deteriorated, but historically significant, areas of Central American cities, particularly in Panama, Guatemala, and Honduras.

Urban revitalization poses a balancing challenge between urban development and social inclusion. In the transition between a neighborhood being labelled “distressed” to “up-and-coming,” all of the community spaces, affordable housing, and retail that support diversity and authenticity can be absorbed by investors whose profit-maximizing perspective does not take into consideration the other forms of capital it puts at risk. Residents can quickly be priced out to the city periphery, causing them to incur prohibitive transportation costs and destroying a delicate social fabric. Cultural homogenization, which can be one result of urban revitalization, is the reduction in cultural diversity and replacement of the unique cultural identity of a place with imported cultural elements. It is also the destruction of cultural symbols embodied in the built environment and loss of the traditions and other intangible heritage in the memory of local populations. Most regulation focuses on protection of physical history because it is easy to legislate and enforce. Protection of indigenous urban populations and businesses is recognized as being important by UNESCO, among others, but rarely taken into consideration at a local level.

To address these challenges, and rather than approaching real estate from a macroeconomic perspective, Conservatorio takes a “bottom-up” approach, using human-centred design to find socially sensible solutions to urban problems and working up from there to make sure that the solutions provide sufficient returns on capital to attract investors. Focusing on deteriorated urban cores, the company proposes that the numerous benefits of urban revitalization can be attained while minimizing negative externalities of

displacement and cultural homogenization.

From the outset of the project in 2005, Conservatorio’s founders had a deep understanding of the benefits of urban revitalization and costs of displacement, having lived through the revitalization process in 1980s Miami and 1990s Brooklyn. Those experiences led to the company’s founding principles, among which were policies of building one affordable unit for each high-end unit (which has led to 65 units to date) and preferring independent retail over chains (over 85%

of the company’s tenants are independent). The company also adopted strategies of enrolling employees from the neighborhood and attracting and founding NGOs dedicated to building social and human capital in order to help local residents take better advantage of the opportunities created by the revitalization of their neighborhood.

### Economics of Mutuality Strategy

In real estate, buildings are fixed in place, but the capital behind them is typically opaque and highly mobile. The ability to avoid bearing the long-term consequences of decisions by simply selling creates an industry with an extractive mentality.

Conservatorio takes an ecosystems thinking approach, viewing its properties as parts of an urban ecosystem where multiple forms of capital must be kept in relative balance to ensure continuing prosperity for the community and the company. The company bases decisions on the assumption that the company’s ownership is known (exposing it to reputational risk) and that it will perpetually retain a stake in its assets (exposing it to the long-term consequences of its decisions):

“Sustainability is core to Conservatorio’s business model. Its long-term build-and-hold approach in socially and politically sensitive areas requires it to think about urban problems in a holistic way. If the company does not, or is even not perceived to, create shared value, its overall business model would be in jeopardy. Accordingly, all staff is trained in systems thinking and other sustainability concepts, to ensure that all business decisions take into consideration the

interests of both the community and the company's investors."<sup>1</sup>

Conservatorio's investment approach focuses on building human and social capital alongside financial capital through its investments. Its core purpose is to better the "quality of life in the city for all," which drives its strategy towards the realization of a vision of dense, vibrant, inclusive and walkable urban cores with ample public goods. This purpose provokes fundamental questions in every project: How much can we improve quality of life for how many people while being responsible to our capital? What is our longest lever for impact in this project? By drawing broad definitions of "stakeholder" and "quality of life," the company necessarily considers tensions among (and leverages synergies among) cultural, historical, financial, and social considerations.

The economics of mutuality framework works particularly well in Conservatorio's business because the company typically buys a critical mass of properties at low prices in distressed areas with buildings with cultural and historical significance, but where financial capital, social capital (trust), human capital (capacities), and built capital have been severely depleted. Investments in real estate, capacity development, cultural activities, and creating community are not only mutually reinforcing, but also increase property values, facilitating increasing amounts of investment. Due to a significant stake through investment in these areas, Conservatorio's long-term financial interests are aligned with the building of social, human, and cultural capital to keep the area economically thriving, while maintaining its cultural integrity.

Furthermore, in designing a model which allows cities to benefit from urban revitalization while mitigating its negative impacts, Conservatorio deconstructs the term "gentrification" into two key components – displacement and cultural homogenization – taking a holistic approach to reducing both. Through these social considerations, Conservatorio is able to drive positive social change, which eventually leads to a higher financial valuation and investment returns.

## The Real Estate Investment Landscape as Context

The commercial real estate industry has low barriers to entry beside the financial capital. As a result, the industry is large, with low margins and highly competitive. Commercial real estate investment funds have focused their portfolios on clearly defined asset classes attractive to risk-averse institutional investors who have a need to deploy large amounts of capital and prioritize steady returns, liquidity, and capital preservation. This conservative institutional bias

shapes the industry around five basic types of property: office, retail, industrial and (to a lesser extent) housing and lodging. Capital within those categories is concentrated on sub-segments and geographic areas that can absorb the scale of capital required by institutional investors while meeting their risk, return, and liquidity needs. This structure makes innovation at scale difficult, especially in developing areas where innovation is perhaps most needed.

The financial dynamic manifests itself as the standardized office towers, housing blocks, shopping malls that shape cities. When institutional capital ventures out of its traditional categories into housing, the same need for predictability has historically led to investment in large tract housing projects on city peripheries where land is cheap and execution is simple.

## Panama and Real Estate

According to the World Bank, Panama ranks sixth out of 18 in terms of inequality in the sub-continent. The richest 20% of the population have an annual income 32 times higher than that of the poorest 20%. Despite relatively high GDP per capita (USD \$3,080 in 1997, USD \$15,000 in 2017), more than half a million people (19% of the population) live below the poverty line, and half of them (10.2% of the population) live in conditions of extreme poverty. The wealth disparity is particularly glaring in the capital city, where high-rise districts abut chronically poor neighborhoods. Panama's unemployment rate is lower than 6% (as of 2017), but more than a third of jobs come from the informal sector and thousands of people lack clean water and decent housing, let alone access to health, education, or transportation. The main economic activities are the Panama Canal (8% of the GDP in 2014), the Colon Free Zone, the flag convenience, and financial intermediation.

The average price of residential properties in Panama still looks very reasonable compared to that of other capitals. The average sales price per square meter surged from \$1600 in 2010 to \$2050 in 2017 in Panama's metropolitan area, according to the Panamanian Chamber of Construction.

## Conservatorio's Investment Approach

Since the 1980s, preservation of heritage has attracted increasing attention. The ways to ensure its preservation in the context of developing cities remain a challenge. Beyond the issue of conservation, urban heritage has emerged as a resource capable of catalysing powerful social and economic changes, particularly in old centres. Considered as a vector of physical and social transformation, the use of culture as a development strategy has become common, notably in the rehabilitation of Paris, Glasgow, and Bilbao in the 1990s.

<sup>1</sup> "Panama City Case," MIT Case Study Platform, accessed 9 June 2019, <http://case-study.mit.edu/panama-city.php>

To act within an established urban centre, however, is not an easy task. Town centres are multifunctional places that require work on both lodging and trade. Two core tensions make downtown historic revitalization efforts particularly difficult to do sustainably. One is the tension between the high cost of preserving historic structures and the financial capacity of the residents and businesses that give these districts their unique characters. The second is the tendency for the inherent attractiveness and central location of these districts to make them so popular that they eventually become “victims of their own success,” losing the physical and intangible idiosyncrasies that attracted the creative energy that led to their revitalization in the first place. Experience has taught Conservatorio that these tensions are wickedly difficult to balance.

To reduce local resident displacement, Conservatorio has an internal policy of building one affordable unit for each higher end unit (affordability in Panama being defined roughly in line with what a minimum wage couple can afford). Sales policies are set to prefer local residents and workers over newcomers. Additionally, to counter cultural homogenization, the company has a tradition of restoring historic buildings, with 30,000 square meters of UNESCO buildings restored to date. Within those buildings, the company invests heavily in creation of space for local cultural organizations, such as theatres, jazz clubs, dance studios, and art galleries. Conservatorio provides rent subsidies to a number of local organizations and businesses that would otherwise be pushed out given the rising commercial rents in the neighborhood.

### **An Example: The Rehabilitation of the Panama City's Historic Center**

Conservatorio's focus has been on revitalizing deteriorated downtown areas. The neighborhood of Casco Viejo is one of the densest and, prior to 2005, one of lowest income urban areas within Panama Metropolitan Region. In 1997, the centrally located neighborhood was declared a UNESCO World Heritage Site, ushering in a cascade of incentives to restore the country's crumbling physical heritage. The incentive laws included penalties for owners who delayed restoration, but no incentives or public policies to build the affordable housing that might have created a route to permanence for the area's human heritage. As a result, during the last ten years the gentrification of the Casco Viejo is notable, with the local population dropping by more than 50% and high-income residents (more than \$2,000 per month income) rising from 3% of the population to 12%. Apartments in the neighborhood are currently the most expensive in the city.

To address this need for systemic change, the company worked with the Community Innovators Lab at MIT to develop a program called LiderazCo that brings residents, businesses, NGOs, and the public sector together in the creation of a shared vision for the community, while training community leaders to organize and advocate for improved public policies. One of the program's early successes has been the inclusion of social housing as a consensus top priority in a coordinated lobbying effort among developers, business owners, and community leaders.

Lastly, Conservatorio started a gang reintegration program called Esperanza San Felipe, which reduced violence by providing education and employment opportunities. This partnership was born out of a need to address rising issues of petty crime and inter-gang conflicts that threatened residents and businesses in Casco Viejo, including Conservatorio. The Esperanza program allows gang members to participate in a 12-week intensive program that requires a commitment to abandon all violent gang activities. The program provides formal job training and placement in local businesses as well as seed funding for business start-ups.<sup>2</sup>

## **Impact Measurement: Integration of Non-Financial Measures**

The company uses different forms of non-financial capital in addition to standardized B-Corp and IRIS metrics, to measure its non-financial impacts. Sustainability for each project is evaluated on the basis of the specific context of the area surrounding the project and measurements are established. Typically, these measurements include:

### **Built capital**

- Amount of affordable housing created (ratio to market rate)
- Building usage mix (percent of residential, office, cultural space, retail, and other)
- Amount of public infrastructure restored (\$)

### **Cultural Capital**

- Amount of heritage buildings restored (m2)
- Amount of space dedicated to cultural activity (m2)
- Independent versus chain retailers (percent)

### **Social & Human Capital**

- Participants in collective impact/shared vision programs
- NGOs attracted to area
- Social investment multiplier (Conservatorio investment vs. attracted third party investment in social programs)

2 “Panama City Case,” MIT Case Study Platform, accessed 9 June 2019, <http://case-study.mit.edu/panama-city.php>

- Reduced commute time of residents (annual average in hours)

Environmental Capital

- Reduced annual kilometres travelled by residents

Shared Financial Capital

- First time home buyers served
- Amount of investment in urban core
- Rent subsidies for NGOs and locally owned micro entrepreneurs

The company also sponsored Panama’s first adaptation of the UNDP Global Multi-Dimensional Poverty index to a community level.<sup>3</sup> Applying the instrument to the Santa Ana neighborhood where many of the company’s projects are located provides a baseline against which the long term effects of the company’s projects can be measured.

### Impact on Decision-making

There are two key interrelated aspects to the decision-making:

- (1) Conservatorio acts as an orchestrator of an ecosystem that looks at the needs of the whole city and its residents.
- (2) Conservatorio drives a purposeful business model based on making decisions and assessing performance in financial and non-financial terms.

The Built, Cultural, Environmental, Shared Financial, Human & Social capital metrics are included in the company’s periodic reports to its investors. To guide decision-making internally Conservatorio has found the need to put all the aspects of non-financial capital into one dimension called Space Curation Index (“SCI”). Conservatorio has developed the SCI as a performance indicator to compare the impacts on the different categories of non-financial capital along with the costs associated with each social investment. Conservatorio has conducted a survey via personal interviews with stakeholders in the ecosystem: Conservatorio’s employees and community members in Casco Viejo. Based on their answers, Conservatorio has built a score weighting each type of impact. The built environment is the most valued with a weight of 0.227. Culture and finance are weighted both at 0.217, and social and human capital are valued at 0.185 and 0.154, respectively. The SCI’s value represents a composite score by which the impact is graded on a scale of 0 to 4 (with 4 representing the highest positive impact and 0 signifying no or negative contribution).

The SCI allows Conservatorio to prioritize the development of projects according to a weighted score based on the values of its stakeholders of the ecosystem. As noted above, all employees participate in sustainability training. One of the key components of this training is a “tragedy of the commons” simulation that trains employees in techniques for creative collaboration to solve seemingly intractable problems. This appreciation of the complexity involved and an understanding of collective leadership is a foundational element of the company’s approach.

Figure 1: The Space Curation Index



3 “Global Multidimensional Poverty Index (MPI),” United Nations Development Programme (UNDP), accessed 9 June 2019, <http://hdr.undp.org/en/2018-MPI>

## Challenges

Operationally, Conservatorio's approach requires an agile development, sales, operations, leasing, and social impact strategy that can adapt to changing circumstances at the ground level. Executing the strategy requires a team passionate and creative enough to deal with complexity, but disciplined enough to deliver the financial results that investors require.

The company's agility has allowed it to develop almost every category of project (office, residential, hotel, and retail) in almost every market level. The company builds some of the most affordable apartments in Panama City as well as the most expensive, and has hotels from \$12 per night up to its most luxurious five star boutique hotel, all within ten blocks of each other. The company owns some of the most expensive retail in Panama City, located a few feet from subsidized local shops that pay rents 90% lower.

To a conventional commercial real estate investor this diversity of product might initially seem unwieldy and incoherent, but over the long term, the diversity, vibrancy, and authenticity created by this mixed-use, mixed-income approach creates neighborhoods with inherent diversification and stability—precisely the characteristics institutional investors seek. This institutionalization of sustainable development and operation of urban real estate is one of the company's long term goals.

Additionally, the company's efforts have at best mitigated the negative externalities caused by Conservatorio's own commercial activities, but experience has taught the company that one company's mitigation efforts cannot on its own keep the entire system in balance. Moreover, mitigation alone is not enough. Impoverished communities like Casco Viejo are captive to highly complex, mutually-reinforcing negative social, political, and economic dynamics that are forceful barriers to social mobility. The rising economic tide created by urban revitalization efforts can lift many boats, but tends to wash away historically marginalized populations if additional effort is not made to prepare them to take advantage of the opportunities it creates. Seen this way, urban revitalization can be a powerful lever for social change, but only when it is coupled with a shared vision of an inclusive future, held among a critical mass of stakeholders.

Furthermore, the fact that their individual effort did not stem the overall gentrification of the Casco Viejo neighborhood led the company to a deeper understanding of how only collective action can lead to systemic change. This lesson led the company to work with MIT Community Innovators Lab to develop a collective leadership program, LiderazCo, and create a subsidiary, Conservatorio Urban Innovation, dedicated to managing multi-stakeholder processes at the neighborhood and municipal levels. As the company enters into larger projects in adjacent areas and other countries the company views these capabilities as critical pieces of the effort to co-create broadly held shared visions for more inclusive policies.

One of the most difficult aspects of this program is reaching the intended beneficiaries. Low income households have several barriers to access to property:

1. A psychological barrier: household members live with informal jobs, chronic stress induced by a struggle to survive, family problems, gang-culture, a lack of savings, and in an economy that is often hit by crisis.
2. A structural barrier: retail banks are often unwilling to grant mortgages to low income residents without any substantial savings or formal employment.

As a result, in early projects, the beneficiaries were mostly low-middle class employees of Conservatorio or other people well-known to the company. In order to expand the pool of potential beneficiaries Conservatorio intends to provide different types of social services to help the neighborhood to combat stress levels of its residents. Going forward, Conservatorio is working on a credit support mechanism that will complement traditional bank qualification criteria with more holistic indicators tailored to the realities of modern urban life. By taking into consideration things like use of public transportation, rental payment history, non-traditional family arrangements and informal income, Conservatorio hopes that it will be able to provide backstop guaranties for many families who are currently disqualified by local banks, allowing them to purchase apartments in the neighborhoods where they grew up.

## Prognosis

Conservatorio's Sustainable Urban Revitalization approach is interesting for a case study because it is a potentially scalable model that applies a shared capital framework to a global problem. Real estate is a ubiquitous business and cities house the majority of the world's population so it is imperative that the industry develop business models that create mutual benefit. Conservatorio seeks to lead this shift in Central America, where high inequality levels combined with decades of poor, automobile-centric urban planning promotes a vicious cycle that has created unsustainable cities.

Conservatorio's model has high potential for scalability because it is designed to provide investor returns while addressing basic needs for many segments of the socio-economic pyramid. The company is currently focusing on developing a base-of-the-pyramid rental property model with embedded social services that lead to rapid social mobility for its tenants. The model contemplates using affordable housing as a way to not only address basic needs of shelter and security, but also as a platform for addressing psychological needs for community and self-actualization, while reducing cost of living through shared services and group discounts. By integrating financial inclusion mechanisms such as using rental payments to create credit histories and preferred access to affordable for-sale housing, the company hopes to provide marginalized communities with a clear pathway to equity.

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Saïd Business School at the University of Oxford blends the best of new and old. We are a vibrant and innovative business school, but yet deeply embedded in an 800-year-old world-class university. We create programmes and ideas that have global impact. We educate people for successful business careers, and as a community seek to tackle world-scale problems. We deliver cutting-edge programmes and ground-breaking research that transform individuals, organisations, business practice, and society. We seek to be a world-class business school community, embedded in a world-class university, tackling world-scale problems.

### **Mars Catalyst and the Economics of Mutuality programme**

Mars' approach to business has long since been guided by five principles – quality, responsibility, efficiency, freedom and mutuality. Together they inform and guide the actions of all Mars associates every day as they do their jobs and interface with the outside world.

The origins of the Mutuality principle go back to 1947 when Forest Mars Snr, who led and grew the business through the 1920's to the 1960's, wrote a letter to all 500 associates of the company that said "the sole purpose of the company is to create a mutuality of benefits with all stakeholders that the company touches; from suppliers to customers as well as governments and competitors and naturally associates and shareholders". This far-sighted thinking, that the company could only be successful if everyone around the company was being successful, has been a cornerstone of Mars' business philosophy ever since.

Mars has therefore always been interested in how it can best live up to this principle; and to find new ways of driving mutuality with all stakeholders it touches. This led to Mars' leadership tasking its economic research unit, Catalyst, to start new work into unexplored territory for business; to identify critical drivers of mutuality and, using business pilots, to develop and test new metrics and management practices that can help boost mutuality in business situations. This work has been called the Economics of Mutuality.

This work has established promising links between increasing social, human and natural capital (that can be measured with simple & stable metrics) and a corresponding increase in financial capital – demonstrating how a company can do both good and well at scale. A number of pilots have now been completed in the areas of micro-distribution, the employees of Mars and in agricultural development that suggest that these relationships are true in different places and situations.

### **The Oxford Mars partnership**

On the back of these promising findings, a multiyear partnership with Oxford University's Saïd Business School was established in 2014 to focus on the development of a business management theory for the Economics of Mutuality with corresponding teaching curriculum, new management practices, and case study research. The research programme has combined the pursuit of normative questions – what is

mutuality and how should it be enacted? – with grounded, ethnographic research on current thinking and practices. This has led to the development of field experiments and case studies examining how large corporate actors conceive of and pursue responsible business practices, and how these relate to their financial and social performance.

### **Mutuality in Business**

Tel: +44(0)1865 422875

Email: [responsiblebusiness@sbs.ox.ac.uk](mailto:responsiblebusiness@sbs.ox.ac.uk)

Web: [Economics of Mutuality](#)

Web: [Oxford Saïd Mutuality in Business](#)