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'The reputation of business'

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The reputation of business has taken a severe knock during the recession, and not just in the banking sector.

I want to talk today about why this matters.

And I would like to start a conversation with you about what we might do about it.

Whichever way you look at them, the opinion polls tell the same grim story.

Four-fifths of respondents in a recent UK survey said they didn't trust business leaders to put the needs of their employees and shareholders ahead of their own personal interests.

Almost as large a proportion thought that business ethics had deteriorated in the past decade.

Executive pay; environmental responsibility, openness with information: all these have surged ahead as issues where the public thinks that company behavior has fallen short.

Why should we care that the reputation of business has fallen in the eyes of the public?

I'd like to suggest that there are at least four reasons why we in business should be seriously concerned about these trends.

The first is that the public faith in the workings of the market has been severely shaken by the events of the past two years.

Following the collapse of communism 20 years ago, the power of market forces reached out into every aspect of our lives. Hundreds of millions of people were lifted out of poverty, and it seemed for a while that a combination of enlightened self-interest and open competition offered a clear pathway to rising levels of prosperity everywhere.

But then we were reminded in the most shocking way that markets themselves are capable of failure.

For me, the *mea culpa* of former Federal Reserve Chairman and once revered maestro, Alan Greenspan, said it all:

“Those of us who have looked to the self-interest of lending institutions to protect shareholder’s equity (myself especially) are in a state of shocked disbelief,” he observed sadly.

There is a lot less talk these days about the magic of the markets. As Daniel Yergin wrote in yesterday’s Financial Times, “the focus is on what goes wrong with them, along with bitterness, suspicion and outright hostility.”

And governments around the world are retaking substantial parts of the commanding heights of their economies, albeit in a kind of random, haphazard sort of way.

It seems highly unlikely that the world will return to business as it was before once the recession is over.

And if business is regarded as a pariah by the public and the politicians once the dust begins to settle, there will be a price to be paid - probably in the form of regulation, higher taxes, or a combination of the two.

Let me give you a concrete example of what I have in mind.

One of the most shocking stories to be published in the past shocking 12 months was set out in the Inspectors' report on the so-called Phoenix Four - the four individuals who attempted to save MG Rover. The business was probably unsalvageable in the shape it was in when they took it on, and nothing they did when it was under their control was in breach of the law.

But the rewards they took for their failure appeared unconscionable.

And the threat raised by what happened is this. If business people are willing to behave in this way and the rules don't stop them, it's only a short step to saying - let's have a lot more rules.

And pretty soon you would find yourself in an environment where risk taking and entrepreneurial drive are smothered out under mountains of fresh red tape.

We are probably in for a rough few years, whoever wins the coming general election. Fiscal consolidation is inevitable, and with it some very painful choices about cuts in public spending and/or increases in tax rates. It's likely to be a period of public austerity.

Business just has to be on the right side of the argument in this difficult environment, which means that it has to be seen to be absolutely at the heart of a healthy society, not some venal vested interested doing its own thing on the margins.

A second important reason why business reputation matters is this.

Our society is now embarked on what will be one of the biggest challenges of this new century, which is about environmental sustainability.

Of course the threat of climate change is at the front of all our minds in the run up to the Copenhagen summit.

But food security, water supplies and the availability of vital raw materials are also important parts of the same story.

Market forces by themselves won't be enough to drive the changes in behavior that will be necessary if we are to adapt the way our economy works in a timely fashion.

For example, unless the Government manages one way or another to establish a meaningful price for carbon, we will not make the investments on the enormous scale that will be needed to cut back greenhouse gas emissions drastically.

The CBI has been arguing for the past two years that we need to make environmental sustainability a shared national priority. Government sets the rules and provides the incentives, business developing the new products and services necessary for the shift to a low carbon economy, and working together, government and business empower consumers to make the choices that will make this whole agenda possible.

In an interesting speech last week, David Cameron reflected a similar theme. "We want," he said," to build a strong co-operative relationship between business and the next Conservative government: sharing responsibility to bring about a sustainable future."

That's all very good - but again it will be the reputation of business that determines the role it can play in helping to develop this new world.

Will the default setting of government be co-operation - or regulation? The answer will depend at least in part on where business stands in the eyes of the voting public.

There's a third reason that the reputation of business matters more than it has done in the past, and that's this: there are no secrets any more. In today's world,

information flows freely everywhere, and no institution - certainly not business - can hide behind a comfortable veil of obscurity.

Back in the mid-1980s, a former spook called Peter Wright published his rather tedious memoir *Spycatcher*, which was promptly banned from distribution in the UK. All kinds of more or less absurd court cases followed in the effort to keep this dangerous document out of the UK - you may remember one luckless and very senior civil servant having to acknowledge to an Australian court that he might have been "economical with the truth". Common sense was eventually delivered four years later by way of the European Court of Human Rights.

Contrast this with a story last week, when lawyers acting for a Swiss-based multinational, Trafigura, tried to prevent newspaper reporting on a question that had been raised in Parliament about the company's affairs. Within minutes, the bloggers and the Twitterers were on the case. And within hours, the lawyers withdrew their injunction.

We live in what Mr. Cameron's Conservatives like to call a post-bureaucratic age, in which communications reach a new level, with all of us connected instantly and without cost to each other. Gone, they say, are the old certainties of centralised administration and concentration of power. In its place, you have open government and inventive energy distributed throughout all different kinds of networks and communities.

All this may sound a bit like the modern Conservative Party's answer to New Labour's 'Third Way'.

But it does have some grounding in reality. And it's another reason why business has to win the trust of the communities in which it operates, and burnish its reputation as a force for good.

The alternative is to be seen as something hidden under a stone that needs to be kept in a corner and harried whenever appropriate.

In a world without secrets, the behaviors which build or destroy reputations become a matter of critical importance, whether you are politicians claiming expenses, the BBC paying its stars - or businesses making profits.

Finally, what applies to the business sector as a whole is also likely to impact with even more force on individual firms.

Put simply, a company's reputation in this post bureaucratic age will in good measure determine its ability to recruit the best talent on to its payroll, and to attract and retain customers in a highly competitive global marketplace.

All this, adds up to a very important set of issues for business - and one that is not going to look any less challenging after the general election, no matter what the outcome.

Ideology is dead, and with it the old certainties of left and right. A Conservative government would be at least as likely as Labour to give business a kicking if it thought it was in the wrong place.

So what's to be done? How should business go about rebuilding its reputation and presenting itself as what it is - the creator of national wealth, well-being and jobs, and the mechanism to pull us out of recession?

I'll need the advice of businesses to help me answer this question properly.

But let me attempt to start the ball rolling now.

First, business needs to build on its success. There's a striking example of what I mean going on right now, and it's not been properly recognised in the public discussion.

If you'd locked a bunch of economists in a dark room a couple of years ago and asked them what would happen to employment if national output fell by 5.6 per cent, you can bet they would have come up with lots of different answers - and they would all have been a lot worse than the actual figure - which is a drop of 1.6 per cent.

There are several explanations for this outturn, including successful government measures to support the labour market.

But the big story is that employers and employees have agreed to make sacrifices to keep job losses to a minimum. Wage freezes and wage cuts. Short time working. In a way that has not happened before, people have understood the trade-off between wages and job security, and acted accordingly.

This, it seems to me, implies a much improved flow of communications within companies, and a degree of trust between employer and employee that just wasn't there before. And it's not simply been a one-way street. Company directors in businesses I know have led the way by cutting their own wages first.

We need to do more to recognise what's going on here, and to remember this spirit of cooperation when the recession ends.

We also need to do a much better job of explaining the role of business in society as the source of wealth and job creation, and of highlighting its positive impact on the communities in which it operates. I'm not just talking about corporate responsibility here, although that is important.

But in addition, and in a much more systematic fashion than in the past, businesses need to be reaching out to schools, colleges and universities across the land, offering advice and support to young people and explaining in a way that careers advisers never can what the world of work is actually all about. They need to be working with the long term unemployed and the homeless, because they have a real interest in the health of the communities in which they operate.

I'm glad to say that there are several very important initiatives now under way that are aiming to do exactly that.

As well as reinforcing their strengths, businesses need to be doing more to recognise and respond to their weaknesses in the eyes of the public. I'd like to mention a few.

The most obvious, and the most difficult, is the approach to compensation.

Of course there are all kinds of reasons why pay levels for senior executives in our largest companies have risen so rapidly in recent years: the emergence of a global market for talent; much more exposure to the public eye; a shorter shelf-life for chief executives - I don't need to list them all now.

But it's hard to argue that pay and performance have always been well aligned, or to dismiss the notion that compensation committees too often take the view that the executives under the watch of just about every company should be in the top quartile when it comes to setting their pay. That, of course, is a mathematical impossibility and a sure path to leapfrogging awards.

There is no one-size-fits-all approach to establishing the right rewards. But in the coming years of public austerity, it's going to be especially important that compensation committees set demanding hurdles and rigorous processes for determining pay.

They could do a lot worse than starting off with some guiding principles which are set out in a recent piece of work on the subject from the US Conference Board.

It calls for immediate and credible action to restore trust in the ability of company boards to oversee compensation, and to that end it sets out best practice and clear guidance. Among other things, it says that the compensation committee should think like an owner, and ask itself whether the package would be paid out on the same terms if it had been negotiated on an arm's length basis by the owner of the entire company.

Not a bad starting point.

Bank bonuses are a separate and even more intractable issue.

As HSBC's chairman, Stephen Green, has written: "The public standing of bankers is now at one of its lowest levels for decades. He goes on: "the sins of arrogance, greed, untrustworthiness and callousness are hard to forgive. The perception that some have taken pay and bonuses in vast multiples of the remuneration of ordinary, hard working and socially valuable people – for indulging in an alchemy which has then blown up on their faces and required huge bailouts at prodigious cost to the taxpayer – has ignited fury around the world."

There are no simple policy solutions –suggestions of windfall taxes or a special super-income tax rate make no sense at all. And of course it's true that banking

talent is highly mobile, and can disappear overnight to friendlier climes, which means that unilateral action by one country would be very damaging.

Time will help resolve this issue. Today's trading conditions are exceptionally favourable, with very low interest rates and central banks injecting large slugs of liquidity into the markets. And profitability will be constrained in future as banks build up their capital reserves against their riskiest activities.

But in the meantime, financial institutions everywhere face growing public hostility. The risk is that unless they find some way of hitting the reset button over the next year or two, politicians around the world will attempt to do the job for them.

I'll be brief about two other vulnerable points that companies need to think about when it comes to rebuilding reputations. One is prompt payment for goods and services, the cause of much anger and frustration among small suppliers everywhere. The other is the approach to skills and training. The majority of our businesses do a great job in this respect. But there is a long thin tail of companies that could do better.

Finally, business is going to have to do more to adapt to a world in which there are no secrets.

James O'Toole and Warren Bennis published a thoughtful article – 'A culture of candour' - in the *Harvard Business Review* this summer. They argued that we won't be able to rebuild trust in institutions until leaders learn to communicate honestly -

and create organisations where that's the norm. The fundamental first step, they went on, is increased transparency at every level - by which they meant the degree to which information flows freely within an organisation, among managers and employees, and outward to stakeholders.

Greater openness with consumers is going to be increasingly important. Asda's chief executive Andy Bond talks of a new era of "democratic consumerism". He believes that citizens have lost faith in the traditional holders of power – such as politicians, bankers, and businesses - and that the only way to rebuild trust is through increased transparency. That means, in his words, "inviting our customers into every aspect of our business, being open about how we do things, and giving them more control, more influence and more direct involvement over what we sell and how we sell it."

And organisations can't be open with their public if they are not open with their own people. This is a whole culture shift we are talking about.

There's a fascinating chapter on airline accidents in Malcolm Gladwell's recent book, *Outliers*. It concludes that "the kinds of errors that cause plane crashes are invariably errors of teamwork and communications."

And his data show that although captains and first officers split the flying duties equally, crashes have been far more likely to happen when the captain is in the flying seat.

That may seem counter-intuitive - since the captain would generally have the most experience in the sky. But the fact is that planes are safer when the least experienced pilot is flying because – Gladwell suggests – when the captain is the second pilot there are unlikely to be worries about back seat driving.

One thing we've learnt in the past couple of the years is the shortcomings of the over-mighty chief executive - the captain who is not interested in the first officer's views. And we've seen a number of spectacular corporate crashes as a result.

Again, that's something we need to reflect on as we think about how company's can rebuild their reputations, and prepare themselves for a different and more challenging future.

Ethics and collective judgment, rather than imperial dictat and instinct.

It seems to me important that business talks about these issues, and thinks about what needs to be done to rebuild its reputation. I would love to hear your views.

Thank you.

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