

The Chairman's Inaugural Lecture to the 255th Session of the RSA

By Gerry Acher CBE LVO

Is Corporate Responsibility thriving, dying or will it be marginalised for the quest for profits?

Fellows, ladies and gentlemen, I must first apologise for the severity of the financial crisis and its timing; you will understand that the events of the last few days were not due to happen for another few weeks but the crisis had to be brought forward to make this lecture truly topical! At the RSA, Corporate Responsibility has been with us in some form or another for many years. Indeed over 200 years ago we were concerned about the threat to the health of factory workers from factory emissions. Moving on to the early 1900's Benjamin Rowntree gave a paper from here on some of the housing challenges for employees. More recently Sir Adrian Cadbury was awarded the coveted Albert Medal in 1995 for his outstanding contribution to business and corporate governance. And, of course, we established the Centre for Tomorrow's Company in the mid 1990's and Mark Goyder has gone from strength to strength searching for Utopia in this area.

This evening I should like to look at Corporate Responsibility in four ways.

- How did it start and what does it mean?
- What are the obstacles to universal application?
- What is the impact of the financial services meltdown?
- What I see as the way forward.

How did it start and what does it mean?

In 1953 Bowen published a report called "Social Responsibility of Businessmen" but in practical terms Corporate Responsibility, as we know it today, probably started in 1970 when Nova Nordisk the Danish pharmaceutical group suffered a 50% fall in sales in one single year following accusations, subsequently refuted, that enzymes in its products put employees and users at risk. This was the start of Nova measuring its impact on the environment and engaging in stakeholder dialogue with transparency at the core. Nova is still one of the leaders and their first report was in 1991 followed, in the UK, by Nat West Bank the following year. Meanwhile two years earlier in 1989 Ben and Jerry's Ice Cream published their first social report.

The UK and Scandinavia are probably still seen as the leaders in Corporate Responsibility whilst the US has its own special approach and China should not be ignored but more of that later. One of the problems we encounter straight

away is whether there is a common understanding of what corporate responsibility stands for and what it means. This concern is reinforced by the multitudes of terminologies and definitions for the concept. Corporate Citizenship, Sustainability, Sustainable Business etc. etc. This is partly due to the immature nature of the concept and its continually evolving status. But it also demonstrates how different people, nations and regions interpret the concept in different ways. This only adds to the confusion about what Corporate Responsibility really is, and encourages scepticism from those not involved in the agenda. I understand Corporate Responsibility as “being prepared to share an understanding of the business, the way it is operated and the ethical and other dilemmas that are faced and how these are dealt with in a transparent way”. A little while ago the Economist explained it as being at three levels with each level being additive to the one before. First at the entry level is philanthropy whether in cash or in kind. The next level is risk management of one’s reputation, environmental aspects and the prevention of “own goals”. A good example of the “own goal” damaging reputation would be the pharmaceutical industry not making retro virals available at reasonable cost for HIV and Aids sufferers in the developing countries. Thirdly the Holy Grail, the embedding of Corporate Responsibility objectives into the business in order to get commercial advantage.

Let’s look at each of these levels in a little more detail.

- Layer 1 – Philanthropy

Each country has a different approach towards philanthropy. In the US, shareholding owners set up their philanthropic foundations which handle this agenda so that all the profits made by the company are for its shareholders and not “frittered into the community” by “do-gooders”. This approach could, on the face of it, present conflict with the Corporate Responsibility agenda but there are sufficient other strong drivers in the US that allow the Corporate Responsibility agenda to be achieved through other means. In the UK we have a good track record on philanthropy both in terms of cash giving and community work. In a recent City of London study by Oxford Economics it was found that philanthropic giving in terms of cash or employee time amounted to some £800m per annum. Whilst one might argue that some part of this must be at risk as a result of recession or business failure, some parts are extremely robust. For instance in those professions which rely entirely on the skill of individual employees – particularly the legal and accounting professions - Corporate Responsibility and community involvement is seen as a key differentiator from company to company and a prized selling point in attracting the best talent. Some argue that when the job market tightens and talent becomes more available these policies and practices will disappear like a snow flake on a summer’s day. I believe these merchants of doom are wrong, I believe these strong corporate community programmes are here to stay because the best talent will always be in high demand and I believe that these policies are so embedded in the professional company’s values that they will be sustainable. Indeed this area is developing in an exciting way with community initiatives increasingly focused on the company’s core skills or services thereby broadening their own employees’ capability in their own areas. Meanwhile the economic downturn will, of course, put pressure on Corporate Responsibility and affect cash giving; increasingly charitable organisations will

not be able to rely on this sort of funding for the long term unless it is part of a long term partnership with a NGO.

Many of you will think that Corporate Responsibility stops here – well it doesn't – this is only the start.

- Layer 2 – The embedding of risk strategies to manage reputational and environmental risk. Of course, this should be part of good business and it is interesting that these practices often come about as a result of a major disaster. I have already mentioned Nova Nordisk and its sales losses but another good example would be Shell and its problems a decade or so ago in Nigeria and with Brent Spar making it realise it had a public relations disaster on its hands. The action that Shell took was not just a whitewashing or papering over the cracks but a fundamental review of the values of the organisation. I believe that where companies introduce these sorts of risk management strategies embedded into their organisations as a result of failures they will be more successful when they result from playing catch up with the industry.
- Layer 3 – the true adherence to all the principles of Corporate Responsibility where these are fully embedded into the processes of the organisation; only if there is trust and transparency can the business be truly sustainable. One has even seen commercial advantage gained as a result. Continuing the anti retroviral drugs theme earlier, a mining company found that by distributing these drugs to the miners suffering in sub Saharan Africa, they could lengthen the life expectancy of their workers, and ultimately more than re-coup the costs of the drugs. Whilst the number of such organisations in this layer may be growing, these companies are still in the minority. Ultimately Mark Goyder's report "Tomorrow's Global Company" identifies a new standard: Redefining Success; Embedding Values and Creating New Frameworks (of partnerships)". It was interesting that redefining success was mentioned on the radio this morning by the Sikh leader, Indarjit Singh, as a key imperative following the recent meltdown.

But to be a sustainable business isn't all this just really good business sense? The key pillars of trust, transparency, being aware of one's customers and their communities, being aware of one's supply chain and its communities and, of course, aware of the planet and what we are doing to it? So where is the rub? Why are we still talking about it? So who's high jacking the agenda and why?

I think it has been high jacked in three ways. First in the pursuit of short term profits and short term shareholder value at the expense of a sustainable business model; the problems in the financial services industry are witness to this. Secondly by high profile publicity campaigns covering part of a business sector at the expense of the whole and thirdly and probably quite unintentionally by the box ticking brigade.

What are the obstacles and how can we get over them?

Certainly there is no blame on business education. Business schools around the globe, like David Grayson's at Cranfield, are thriving on the subject; from the

Davos Economic Forum to company leaders pontificating to league tables proliferating. But in some ways the Corporate Responsibility bandwagon has been a catalyst of its own problems.

There are many reasons for Corporate Responsibility not spreading more widely more quickly but one major reason lies at the door of my own profession – the accounting profession. Financial accounting is so strong and so well established, indeed we have had double entry book keeping since the Middle Ages that people will not veer away from it as a prime form of measurement. Yet still in this day and age we have no agreed language for non-financial matters and no standards. Nor do we have universal regulation similar to financial regulation that will enable comparability and transparency.

A group under HRH Prince Charles has recently tried to tackle this whole area of sustainability reporting. But they have not found it easy and, as I can well remember from the days of inflation accounting, people do not like new concepts and would rather stick their head in the sand. Whilst inflation ultimately went away and so inflation accounting as we then knew it, with its Monetary Working Capital Adjustments, died a natural death, sustainability issues will only get more and more dramatic and so effective reporting must be introduced. But it is too early to see whether Prince Charles's initiatives will bear fruit so the companies involved – a number of whom are here tonight - must start putting the concepts into practice and get experience under their belt. These issues must be picked up by the international accounting bodies and by legislators. Voluntary action is ultimately not an option for the way forward. However, whilst carbon issues can be reduced to figures, targets and Key Performance Indicators, it is far more difficult to measure social impacts.

So what are the other obstacles?

Corporate Responsibility in many people's eyes has become *a box ticking exercise*. It is the easy option and has done more to discredit the agenda and I believe slow the embedding of the principles into the business more than anything else. This is the do-gooders side show, the application of a veneer onto the company woodwork with maybe a layer or two of varnish to boot and it can be very misleading.

The more the CR agenda can be satisfied by ticking boxes the more stand alone it becomes in a company's strategy and the more difficult it becomes to embed in a way that a company does business. The Corporate Responsibility department becomes part of the corporate affairs department and thus at the risk of being ditched by a change in business environment such as we are experiencing now.

Marks & Spencer introduced Plan A because it believed the only way forward for its business is through embedded Corporate Responsibility strategies. It was cleverly done, well packaged (excuse the pun) and a great campaign. But nowhere does it refer to corporate responsibility per se; they actively wanted to get away from these words. I am sure some of the reasons lie in that commercial

people look on CR as a side show whilst CR specialists still look on themselves as apart from those who run the business; both these are at fault and both need to move to some centre ground. Otherwise the CR specialist will be without a job; indeed as I mention later maybe this is where we should ultimately move to anyway.

Whilst M&S is regarded as one of UK's leaders in Corporate Responsibility so is BT, but their approach is very different. At BT there is no high profile publicity campaign but a genuine attempt like Nestlé to really understand the issues of the future and as a result they try to build Corporate Responsibility into the business as it grows rather than back filling.

The Government had the opportunity to mainstream Corporate Responsibility and related information into a company's main accounts as part of the operating and financial review but failed to seize the moment when we were all ready and ditched the proposals in 2005 at the last minute. This has certainly set us back, although I am delighted to say that many businesses had prepared themselves with the change and because they saw value in the processes continued along the road.

One key area of development of this agenda is by driving CR down through the supply chain but again a box ticking approach achieves absolutely nothing. And if one is going to engage the supply chain it must be again in an embedded way. There are already good examples such as BT, GAP, Starbucks and others and these are not doing it through ticking boxes but through proper embedding.

Acceptance of the pick and mix approach.

Many organisations pick out that part of the CR agenda they like, publicise it – maybe even campaign on it - and skate over those parts which don't fit their business model. Blatant examples are in the banking industry to which I refer to later but look at the retail industry – on the one hand some supermarket groups promote fair trade and products while on the other hand they set up city and village centre stores driving the other shopkeepers out of business. Another example – on the one hand they cut down packaging and waste yet on the other hand they allegedly send produce half way across the world to prepare for sale and then bring them back again.

Another proponent of the “pick and mix” approach is Starbucks. It makes much of the way it works through its supply chain to the end grower but then is silent on the fact that it manages to open some of its stores in village and town centres by allegedly using inadequate planning laws to its own advantage.

Consumer weakness.

But we can't blame everything on the companies because our consumers seem often little motivated to exercise their power. When Primark got into terrible trouble with the media over the use of child labour in sweatshops in the Far East its dip in sales soon recovered, like a stone cast onto a still pond the ripples soon disappeared into the flat calm again. In fact they are one of the few high street retailers whose profits have increased during the current spending crisis.

Often retailers offering ethically produced goods, instead of pricing them in a competitive way, add significant margins. A recent survey by PriceWaterhouseCoopers identifying whether consumers were buying into the sustainability agenda found that in the top 6 UK grocers a comparison of 75 items comparing the prices between the sustainable alternative and the normal product found an average price premium as high as 45% for the environmentally and ethically friendly products. Consumers will not pay this level and PWC found that the greatest level of premium pricing that consumers would accept was around 20%. With the forthcoming financial challenges facing consumers, this figure is likely to reduce. So at present, under this scenario, ethical products – say bananas (purely for illustrative purposes) – remain high priced and volumes static and their higher profits to the retailer effectively subsidise the standard bananas whose price can be reduced further thus making it even more appealing to the consumer. Thus the ethical produce remains an unobtainable commodity. Consumers have real power to obtain change and they should be encouraged by Government to exercise this power. And this brings us neatly to the subject of Government inaction.

Government inaction

The Government could do so much to bring the whole of the sustainability agenda to the fore for giving consumers and businesses incentives to change behaviour. They could be more positive about waste reduction and to help promulgate the whole concept of whole life costing which would look at energy and environmental costs over the whole life of an asset. Even a simple subject like light bulbs where there was no reason why we could not have become an early adopter of low wattage bulbs, yes the ones that you can't dim and you can't read by, but again we have left other countries to lead the way. If the Government is serious about this agenda there is so much, with a tweak here or there it could do. In South Africa, despite all their problems, they have outlawed the use of plastic bags in one fell swoop.

The Blair Government introduced the Ministerial role for Corporate Social Responsibility some 8 years ago but in the last 4 or 5 years we have had a change of Minister almost annually with little evidence of a lasting contribution to the subject amidst their other responsibilities. As of today we don't seem to have a Minister!

The investment community is also a major obstacle, whether through hedge funds or traditional investment houses, the short term still predominates. Yes longer term strategies are now being taken into account but still little premium attracts to the truly sustainable company with good behaviours. Here I cannot see a real change quickly, other than through the risk agenda where if the risks are not properly mitigated profits will be obviously short lived. But remember how the investment community attacked Lloyds Bank for its dreary lending and how Adam Applegarth of Northern Rock and Andy Hornby of HBOS were the darlings of the investment community for their expansionist approaches.

This neatly brings me onto the impact of the Financial Services meltdown and the role corporate responsibility has played. Maybe I should say *corporate irresponsibility*. It may surprise you to know that both HBOS and Bradford & Bingley, according to the Business in the Community statistics, were some of the finest proponents of Corporate Responsibility being given platinum – the highest – status in the latest BiTC report and in the days that it gave league tables HBOS was 10th and B&B 52nd in the top 100 Corporate Responsible companies. Yet how much of the current credit crunch and banking crisis is due to a failure of Corporate Responsibility principles, for example:

- Mortgages to people who can't afford them
- Valuations giving inadequate, no or negative cover to secured loans.

With regard to these two points one might well ask what has become of the “treating customers fairly” and “responsible banking” codes that all the banks signed up to? So, as we now know, the sub-prime loans were then parcelled up with some good ones added in with the bad. The whole lot were then salami sliced into packages which were then passed round and round the banking system until the music stopped in August 2007. Derivatives which were supposed to be a tool of risk management became profit centres in their own right. The banking industry's answer to weapons of mass destruction as neatly put by Warren Buffett. These instruments gave a new meaning to opacity.

Dealers were paid on the shortest of short term results with bonuses far in excess of acceptable norms.

The executives likewise with their long term incentive plans they did not play to the true long term sustainability of the business and the CEO's who often showed more of the traits of salesmen rather than of bankers. No individual group or person is to blame. The short term results pressure came from the CEO's, the Boards, the investment community; indeed the regulators did little to stop them. This was a massive failure of Corporate Responsibility. This failure has been compounded by the fact that no-one has said sorry. The challenges in this sector to properly embrace CR will be immense.

Yet as I have said earlier both HBOS and B&B were in the BiTC platinum category of Britain's most corporately responsible companies. I submit that these league tables have had their day; they have raised the CR agenda to a particular level but they can take it no further. They rely on box ticking which has an inadequate regard to materiality and ultimately any of these box-ticking indices has to be flawed as people become more sophisticated.

But banks are not new to these disasters.

- In the 1970's we had the commercial property induced crisis

- In the 1980's we had the student loans induced crisis with the wrong assessment of risk
- In the 1990's we had the sovereign debt crisis with poor assessment of risk and later in the 1990's the Asian losses with over £50bn being lost.

So unless something changes there will be more banking disasters within the next 10 years. That is unless banks walk the talk and put prudent banking and transparency ahead of opacity. The banking community have much to learn from the work carried out by the Nova Nordisks, Shells and many others of this world in re-establishing their reputations attempting to put them beyond risk in the future. This is basic corporate responsibility philosophy.

What I see as the way forward.

The Chief Rabbi Sir Jonathan Sacks last Friday morning on Thought for the Day at the time of Atonement said that the life of greed was over and the life of responsibility had begun. Certainly it will be a backcloth such as this which will see this agenda move forward. But the cornerstones of this agenda have always been and will always be trust and transparency and these need to operate within a globalised market context. Indeed globalisation itself is key to the development of this agenda.

To me, a business can be successful in the future on two bases. Performance and behaviour. It is, and should remain, the key focus of the CEO and the board to focus on performance and ensure the business is checking its targets. The role of corporate responsibility, in whatever guise it inhabits, is to ensure that performance is met by good behaviours. One will not be able to perform with bad behaviour in the future.

I believe the impending recession will give a degree of space and a pause for companies to look again at their costs, at their practices and at their waste and energy consumption. Indeed I think we shall see private equity that, in the past, has given as much attention to this agenda as Nelson putting his telescope to his blind eye, they will now move the telescope to the good eye; they will be holding their businesses for longer and they will inexorably be looking to improve their portfolio and increase the value of their businesses, so they will inevitably be drawn to recognise the Corporate Responsibility agenda. However we should not underestimate the strain CR will be under in a recession so it is up to us to remake the argument. Indeed the very global nature of the credit crunch underlines the need to recognise that CR is global and we can't walk away from the billions who live in poverty.

Despite everything being taught in management schools around the world I do not see management of its own volition taking a vast change of direction to fully embrace the agenda. But inevitably and maybe regrettably I do see the pick and mix approach as the way forward whether we like it or not.

In the 1990's – this seems an age ago now – I chaired the international audit practice of KPMG and fought hard for the recognition of principles against detailed regulation. I fought the box ticking community and tried to expose the damage it does. Box ticking regulation never has been or never will be the answer to anything other than the shortest of short term changes of direction. I would love to say that we could drive the box tickers out of the Corporate Responsibility agenda; they have had their day here, they have done their bit but we need to find somewhere for them to go.

I would like to see our Government taking a more coherent line on many of these issues but I fear at present this is a forlorn hope. Over the weekend I re-read my inaugural lecture to this Society exactly two years ago on the subject of personal carbon responsibility and I identified a number of sensible actions that a Government committed to progress in this area could take. Needless to say none of these have been taken and certainly the political environment is no more conducive to taking them over the next few years than it was in the last few years. However, there is hope with the appointment of Ed Milliband and the new Climate Change Bill where the UK is leading the way.

Do I see the investment world moving away from its short termism profit/value model? This will happen one day but whether it is in my remaining lifetime is dependable on a number of things, particularly how long I happen to live.

Whilst the UK and European multi national companies will be leading the agenda I do see progress moving quite quickly and that will be from the US and it will be in at least four areas where businesses will not be able to perform with bad behaviour.

- The fear of environmental litigation will gather at a pace. We have already seen class actions in California against the car manufacturers for pollution
- In a similar vein there will be a fear of human rights litigation and again we have already seen that beginning in relation to child labour and related areas.
- A fear of litigation on resource depletion. The litigation will occur in the US for resources depleted in developing countries, such as water.
- The licence to do business overseas. Increasingly countries overseas in the developing world are going to demand major social and community programmes driven by the multinationals if they are to exploit the resources of whatever sort from those countries.

So I see the Corporate Responsibility agenda delivered by others in order to do business in the short term let alone the longer term. I also see a greater responsibility on our business leaders in the public domain. For instance, the Chairman and Chief Executive of Nestlé recently said that his most strategic imperative was to make sure that Nestlé was still a force in a hundred years time.

I believe the financial services melt down will have a beneficial impact of Corporate Responsibility in the same way that the failure of Enron and WorldCom

had a few years ago. But whether it will be sufficient to drive out all the bad behaviours in the financial services arena we shall have to see.

At present Corporate Responsibility focuses too much on the management of the business rather than the product itself. I think over the coming years we shall see the consumer becoming more concerned over the business it does, it sells and the impact it has. Therefore a tobacco company could never be able to be a good corporate citizen nor the company which exploits poorer communities. When the true scale of carbon reduction needed to preserve this planet is known and understood by the consumer we could well find the airline industry in a more challenging position like the tobacco industry is today with all the impacts on recruitment and so on.

Corporate Responsibility is now on the boardroom agenda – it was not 10 years ago. All but a handful of FTSE 100 companies are now reporting in some form or other whilst 10 years ago the reverse was true. Each year we see a marked increase in sophistication. Companies are starting to look at their supply chains and the agenda is rippling gradually down to the SME – small and medium sized enterprise - level, nationally and globally.

Finally a word about China. They are certainly not ignoring this agenda and as their growth is so much trade led in a global economy there will be a strong sustainable aspect underpinning it. They are making all the right noises but enforcement on the ground is still in its very early stages. There is not the plethora of NGO's in China to work in partnership and push the agenda along but China is demonstrating an increasingly strong climate change responsibility. A few Chinese companies have issued Corporate Responsibility reports (according to a recent Economist report) and referred to them as “beautiful books – not much inside” similarly to many of ours. Let us hope they leapfrog our many mistakes and they truly contribute to the agenda.

So as I draw to our close, may I first of all thank all those who have helped me put some focus on my ramblings, particularly Mark Goyder from Tomorrow's Company and David Grayson from Cranfield, Mike Kelly and Debbie Lowe from KPMG, Cindy Cahill from Deloitte and Erica Holber from PWC.

As I end, Corporate Responsibility has now been growing on us for the last 20 years and may I give a personal thought of what I would like success to look like in 10 – 20 years time. The words Corporate Responsibility will have disappeared from the agenda, the words will become irrelevant in the same way as M&S has avoided using the words in its Plan A – it will be the only way that business can be done. It will have to be achieved against a slowly changing short term corporate growth model and that will mean a continuation of the pick and mix approach and the risk of further failures like the banking crisis.

But I am reminded of Jonathan Porrit's words, which are absolutely relevant to tonight's discussion “...whether capitalism really is capable of delivering a genuinely sustainable, equitable economy... it had better be. It is the only game

in town, and will be for many years to come.....this means working with the grain of markets and free choice, not against it. It means embracing capitalism as the only overarching system capable of achieving any kind of reconciliation between ecological sustainability, on the one hand and the pursuit of prosperity and personal wellbeing on the other”.

Are we re-floating the Titanic or are we just moving the deckchairs? I believe we are slowly but surely moving the Titanic and as Robert Kennedy famously said “Few will have the greatness to bend history itself but each of us can work to change a small portion of events and in the total of all of these acts will be written the history of this generation.”

Fellows, Ladies and Gentlemen. Thank you very much. I would be happy to take questions.