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## Special Feature: An interview with Philip Sadler

**Philip Sadler CBE is a business educator, consultant and the Vice-President of Ashridge Business School in the UK**

***Q: In your book, Building Tomorrow's Company - A Guide to Sustainable Business Success, you urge an 'inclusive approach' to governance and management. What do you see as the essentials of this approach?***

***A:*** The four basic essentials are: a clear purpose that includes, but goes beyond, shareholder value and is capable of motivating and inspiring people; a business success model based on an understanding of the drivers of long-term sustainable business success - and that business success model would differ from one company or one industry to another; mutually trusting and beneficial relationships with key stakeholders, i.e. investors, customers, employees, suppliers and local communities; and the 'winning of the licence to operate' by which I mean establishing and maintaining the kind of reputation for integrity and socially responsible behavior that enables the company to be respected in society.

These essentials need to be formally adopted through discussion as to the company's direction, goals and values. What we are talking about is 'reinventing' the company in the context of what is going on in society. This kind of rethinking what a company is 'for' has been prompted by growing discontent about global capitalism.

***Q: There would seem to be a notable dichotomy between 'Wall Street's hunger for short-term growth' or, say, that of the City in the UK, and the recognized connection between inclusiveness and sustained business performance. Where did the concept of inclusiveness arise?***

***A:*** This is a tricky issue. Fund managers are sensible people and they endeavour to invest in companies with a long-term future. The problem arises because they do not have sufficient understanding of what it is that will ensure long-term sustainability. Because they consider current profitability to be some sort of guide to the future, they concentrate on financial ratios instead of investigating some of the more fundamental features of the company. Take the example of Marks & Spencer. In the late 1990s when the company declared the first £1bn profit ever for a UK company, there was huge excitement and pressure to buy. The following year the company collapsed. The problem was that analysts never really looked at levels of customer satisfaction and the attitudes of employees, and both sets of stakeholders felt that they were being 'short-changed' by the then management. Failure to address these issues contributed to a collapse of Marks & Spencer sales and profits.

The short-termism of the financial markets arises from the pressure which fund managers face from pension funds that seek to produce results quarter by quarter which are in the upper quartile among fund manager companies. To achieve this they will sell investments which they know are going to be good value long term in order to be able to buy other investments which they feel will make a good showing this year. They are effectively trapped into taking a short-term approach.

The inclusive approach is not some concept dreamed up in academic circles. The term was first coined by a consortium of 25 companies that in 1995 produced the Royal Society of Arts Report, An Inquiry into the Nature of Tomorrow's Company.

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***"The picture is mixed. Whether a company is very large or very small, an autocratic top manager will run the company his or her way for good or for ill. What we're trying to achieve in corporate governance reform is to prevent that happening."***

***Philip Sadler***


Some of the strongest advocates of the approach have been leading people in industry such as Anita Roddick of Body Shop, Philip Watts of Shell, and Sir John Egan who, until recently, was Chairman of the Centre for Tomorrow's Company. It is also interesting to note the tremendous growth in the City and on Wall Street of SRI - socially responsible investment funds, which I would describe as sustainability funds. This is the fastest growing sector in the investment world.

***Q: Is global competition hindering moves towards corporate sustainability?***

***A:*** Obviously if you have a market economy competition is an integral part of it and, as the economy of the world has developed, the competition has moved from local markets, to regional or national and now increasingly a global scale. Whether you are a company operating locally, regionally, nationally or globally, a sustainable business is by definition one that builds and maintains a competitive advantage. The question is, how do you achieve that? In my book I mentioned research from Stanford University which was published under the title Built to Last. This provides extensive evidence that companies that can maintain a sustainable competitive advantage for some 50 years or more are those that have embraced the inclusive approach. They don't necessarily use the word 'inclusive' but, when you look at corporate policies and practices, these follow an inclusive model. Good examples are companies such as Hewlett Packard, 3M, Johnson & Johnson and Merck. So the answer to the question about the impact of global competition is really that competition does not impede a company's achievement in sustainability. However as competition is increasingly intense, companies must be managed in a very astute way to ensure they remain competitive.

***Q: Companies are more vulnerable than ever to negative media coverage and resultant damage to reputations. To what extent are such pressures a catalyst for change in approach to business?***

***A:*** I certainly agree that media exposure and some of the upsurges of public indignation we have seen are very powerful catalysts for change. This of course is not really new. It has been the case since Charles Kingsley exposed the plight of boy chimney sweeps in the mid-nineteenth century. Once the media see a practice which is not in accordance with current social values, they will speak out against it and others will pick up on this. A recent example is the publicity given to behaviour in the investment sphere in companies such as Merrill Lynch. Such pressure leads to action, in this case the erection of 'Chinese walls' between investment bankers on the one hand and analysts making recommendations about buying or selling shares on the other. So change occurs in a piecemeal fashion - but certainly media exposure has been very effective.

This said, this does not always exert a negative effect. A company that is confident that it has measures in place to prevent, say, fraud or damage to the environment has nothing to fear as long as it remains transparent and admits to any mistakes that it makes. What is damaging in the long run is not being fully transparent and adopting a defensive stance when caught out.

***Q: You make the point in your book that, while people have a right to expect industry and indeed other institutions to behave responsibly, they too must bear the responsibility of acting as socially responsible stakeholders. What sort of questions does this raise for business in its relations with and example to the public?***

***A:*** Business needs to be proactive rather than reactive, recognizing important issues and responding through practical measures that also educate customers. A good example of this is B&Q's stance against using rare hardwoods in its products, seeking out a substitute material. Another example is the taxing by the Irish government of plastic bags in supermarkets in the Irish Republic. In the UK in supermarkets such as Waitrose and Tesco re-usable bags are sold at minimal cost and then replaced for free when necessary to dissuade use of excessive numbers of plastic bags. But few people seem to use these even though most would surely agree with the need to preserve the environment and avoid filling up landfill sites with plastics. I believe supermarkets in the UK should now go further, without waiting for government intervention - which could take years. Supermarkets should not only offer re-usable ‘bags for life’ as some already do, but they should announce the planned withdrawal of ordinary plastic bags, after which solely brown paper bags will be offered free at point of sale, as is the case in the United States.

I would also like to see supermarkets give more space to Fair Trade products. These are as good in quality as their more commercial rivals but they provide a far better income to producers of raw materials in developing countries. I’d like to see companies being much more proactive in their promotion of these products.

***Q: Is size of business a factor in pursuing inclusive policies?***

***A:*** While it is difficult to generalize, many small business people are clearly in business only for the money. Some will try and avoid health and safety rules if they can and will pay the bare minimum wage or even less if they can get away with it. But there is no reason why a small company should not be inclusive because basically inclusivity is not about resources, it is about building relationships. Equally, of course, there are many very large businesses that pay the bare minimum wage so I am not making statements about size as such but I believe it is wrong to put small businesses on a pedestal and demonize large companies. The picture is mixed. Whether a company is very large or very small, an autocratic top manager will run the company his or her way for good or for ill. What we’re trying to achieve in corporate governance reform is to prevent that happening.

***Q: Do the values underlying inclusiveness require a visionary kind of leader or leadership team?***

***A:*** If we look at some of the companies that have a very good record for the way they treat their employees and the value they give their customers, contributions to the community and so on over the years, it is interesting to note that many of them have maintained an approach to doing business which was instituted by the company founder or founders. Hewlett Packard’s approach, for example, was established by Bill Hewlett and Dave Packard. Unilever’s was determined by Lord Leverhulme. These people were visionaries in their time. They believed that it was possible to do well by doing good. Consider the Pilkingtons who endowed most of St Helen’s in terms of libraries, schools and so on. Going back even further you have Robert Owen, the most successful entrepreneur of the early nineteenth century, who created the New Lanark village in Scotland, now a world heritage site.

Such people are rare today because we live in a different environment. Business leaders are generally no longer chairmen who own the business, but people who are servants of the investment community. They have been selected for those jobs not necessarily because of their values, but because they are smart lawyers or good accountants or similar. This can mean they have little understanding of expectations and needs of customers and employees. But, while it is certainly valuable to have a visionary individual emerge as leader, the main thing is the checks and balances which will ensure that leadership is widely shared. Some of our corporate governance rules address this.

## Investors shout: we've been Enron'ed!

**The collapse of energy giant Enron is the largest bankruptcy and one of the most shocking failures in US corporate history. In just 15 years, Enron grew into one of the ten largest US companies. It embraced new technologies, established new methods of trading in energy and seemed to be a shining example of successful corporate America. But apparently the company's success was based on artificially inflated profits, dubious accounting practices, and - some say - fraud.**

The fall of Enron has sent shock waves through the stock market, shaken investor confidence and sparked renewed clamors for substantive reforms in areas including:

- Financial reporting;
- Corporate governance;
- Executive compensation

"Enronitis" has been detected among the bluest of blue chips, and in markets all over the world, as investors question the companies they own. Put in perspective, Enron symbolizes the psychological rock bottom in the stock market after years of hyper-growth in the 1990s and the dramatic rise and fall of the dot.com craze.

In the post-Enron era, investor relations vaults to the top of the corporate agenda as companies must begin to rebuild investor confidence. While companies sift through the many questions investors are raising and the numerous proposals for change, proactive companies have the chance to distinguish themselves and create a competitive advantage. As the marketplace calls for faster, more transparent, more-easily-understandable financial data, the same investors punishing companies may well reward those that provide innovative answers to their needs. But in response to a turbulent, hyper-sensitive market, what can companies do to restore confidence?

According to a survey conducted by TowersGroup, a New York public relations firm, and Opinion Research Corporation, 43 percent of active, individual investors have less confidence in the stock market following Enron. Further, 88 percent believe Enron executives, board, auditors or attorneys intentionally misled the public.

But opinions are still divided on whether the gloom will persist. Pessimists argue that there are plenty more firms to investigate. The first jitters were seen in the shares of firms that were either similar to Enron in their business model, or had direct dealings with Enron. Shares in Dynegy, the trading company that came close to acquiring Enron last year, have lost more than half their value since the beginning of December, for example.

After hammering companies with direct links to Enron, bearish investors have turned their fire on any firm suspected of using similarly deceptive accounting practices. The main casualties, recounted by BBC News Online, have included:

- US conglomerate Tyco, hit by a lawsuit from shareholders, alleging that its network of off-balance-sheet subsidiaries concealed problems. The firm had made over 200 acquisitions over the past three years.

- Shares in Enterasys Networks dropped by 61 percent in one day, after the hi-tech firm admitted that the SEC is investigating it and unidentified "affiliated companies".

- Cable firm Global Crossing, another client of auditor Andersen, went bankrupt after suffering a collapse in investor confidence.

Most of these companies have something in common. Even during their fashionable periods, they were high-risk, high-return investments, willing to do whatever it took to dominate their dynamic, highly competitive markets. What is so notable about Enronitis is the way that it has also started to afflict some of the most venerable names in business on both sides of the Atlantic:

- General Electric, one of the world's biggest companies and a darling of investors for decades, has come under fire for its accounting practices. Although no one alleges any form of malpractice, the company is seen as too sprawling, complicated and diverse (some traits common to Enron).

- British engineering giant Rolls-Royce has been the subject of newspaper speculation - which it denies - that its shareholders were concerned over accounting irregularities.

- Shares of IBM took a brief nosedive after a rumor, ultimately unfounded, circulated that it was under investigation by the Securities and Exchange Commission (SEC)

By themselves, none of these jitters is particularly unusual. But the fact that they have emerged at all, and all at the same time, is a function of the market nervousness that Enron has created.

How did we get here? Surely the fall of Enron is the defining moment, but the pressure had been building for years. Phil Livingston, president of Financial Executives International, a US-based professional association for CFOs, controllers and corporate treasurers, cites a variety of contributing factors. These include:

- Market pressure for performance increased dramatically over the past ten years. The result has produced better returns for shareholders, but also a higher fatality rate as management teams have pressed too hard at the margin.

- Regulators issued overly complex accounting standards that were unintelligible and irrelevant to bigger problems (like new rules for accounting for derivatives).

- Boards have not kept up with the challenges of the assignment. True financial reporting experts are needed to serve on boards of directors, specifically on the audit committee.

**Calls for reform**

Enron's legacy will not only be its catastrophic harm to shareholders and employees, but as the catalyst for wide-ranging reform. In the US no less than a dozen different Congressional committees have taken up some type of corrective legislation, and the SEC and other regulatory agencies have been busy as well. Various stakeholders, including institutional investors, business groups and others, are also advancing reforms, too many to recount in detail. Among the issues being debated are two at the core of investor relations - how fast is fast enough in disclosing financial data to investors and the continued confusion over growing differences in the reporting of corporate earnings from company to company.

While faster disclosure may be better in theory, is it necessarily better? According to Lou Thompson, National Investor Relations Institute (NIRI) president, more importantly, disclosures need to be understandable. "Most good writers labor to ensure they are communicating clearly and precisely while conserving on words. Companies need to follow the same practice in writing for investors."

Certainly investors have greater access to information today than ever before. A recent NIRI survey found that 92 percent of companies surveyed provided access to quarterly conference calls to investors by phone or over the Web. Further, companies can now choose to automatically post their information on finance portals such as

Yahoo!, Forbes and The Motley Fool.

Another SEC reform effort calls for companies to include in annual reports clear, concise descriptions of their accounting policies and how they affect earnings and revenue. It directs management to disclose in plain English all the factors and accounting assumptions that could affect the company's future performance.

**Global giants GE, AIG respond**

Certainly corporate America has not been blind, deaf and dumb to the fallout from Enron. In fact, some of the largest US companies have moved quickly to address investor ire.

General Electric CEO Jeffrey Immelt, at least publicly, welcomes the added scrutiny in his company. In his speech to shareholders in April, he lamented GE's stock price, down to 1999 levels, but reasoned: "Performance is not enough. When a trillion or so in new economy market cap goes up in smoke (dot.com crash), when advisors rate a stock a `buy' and then it goes bankrupt a couple of weeks later (Enron), when the system designed to provide confidence in the numbers falls apart, it changes things."

**Lessons learned for the IR officer**

After Enron, clarity will be valued above spin. Simple, practical communication tools for the average investor should be the focus. Analysts, with now wounded reputations, will demand better direct communications from the company and still more disclosure of information. To assist, companies should employ use of the Web to provide rapid and simple access to financial information. Many companies are aggressively moving to XML-formatted financial statements, segmented into easily accessible pieces with links facilitating access to key data. Additionally, opaque, unreadable legalese must be discarded from financial reporting. The communications skills of the IR specialist will be more important than ever. But there must be more balance than in the past. The duty to put the company's best foot forward must be subordinated to the need to restore investor credibility. It's also urgent for companies to demonstrate their trustworthiness to regulators, or they will find themselves subject to a batch of new requirements. Everyone seems to think we can do better. The current hoo-ha over Enron and the role of the accounting profession may well result in new, tighter rules for corporate financial reporting. At the very least, it should encourage investors to look a little harder at the companies they own.

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***This is a review of a "Building mountains in a flat landscape: investor relations in the post-Enron era" which appeared in Corporate Communications: An International Journal Volume 7 Number 4 2002.***

***The author was Christopher E. Allen of Financial Executives International, Morristown, New Jersey, USA.***

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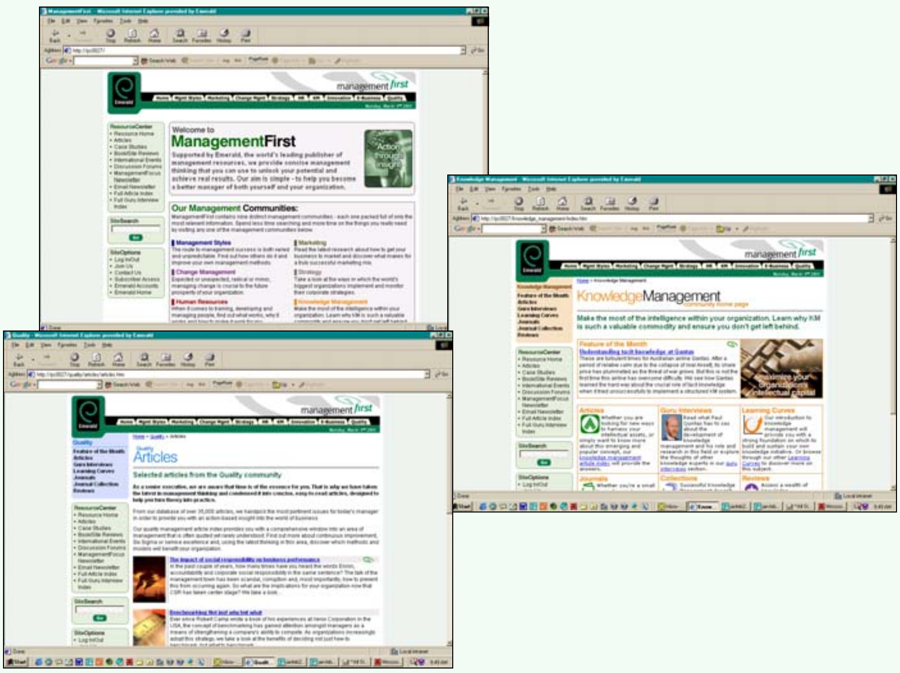



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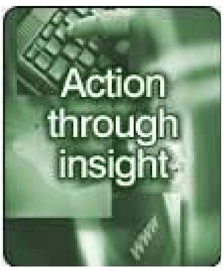
***-Winston Churchill***

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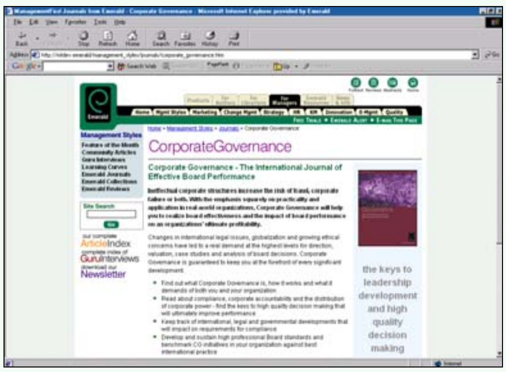


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