

**Lecture by Niall FitzGerald, KBE, to the 2009 Postgraduates of the Kemmy Business School and an invited audience from the business community, on the occasion of the official opening (by Mr FitzGerald) of the KBS Trading Floor on 4<sup>th</sup> Sep., 2009.**

Good morning. Thank you for that kind introduction.

It's always a pleasure to come to Limerick.

And it's a particular pleasure to come to the Kemmy Business School, to be among a group of people who have served Irish academic and business life with such distinction...And among a group of people we hope will find similar distinction, whether on these shores or all around the world.

We meet as the business world is sickly. Some big institutions have gone to the wall. The reputation of many others has fallen pretty low. The roles and abilities of business leaders are in doubt.

We are living through the very practical consequences of the crisis, which has affected people a long way from the financial centres where it started. Here in Ireland, unemployment has risen faster than anywhere, much of it on the back of the collapse of the building boom. Two years ago, Ireland had the second lowest unemployment rate among the EU-15 countries. Now it has the second highest.

It is not the most obvious time to be chasing a career in business.

So maybe I should start by asking a blunt question.

Why are you lot here?

This financial crisis has turned into a deep recession – and nowhere deeper than in Ireland.

So why would anyone choose a career in business right now?

A number of businesses are dead. We know that some others will never recover. Those that do will no longer pay the top dollar that they did before.

So what makes bright people like you think it's worth your while?

Well, since I'm up here at the lectern, I'll give you an answer.

Paradoxically, I can think of no better time to come to business school.

In the last year we have seen a culture of 'reward for failure' for business leaders. Bosses and boards have been unwilling to acknowledge any responsibility for their part in the crisis. We've seen no acceptance by these so called leaders of their accountability. We've witnessed not only an economic, but also a moral failure.

Things have gone so wrong, that the challenge now is to find a better way of doing business, to restore its reputation and to win back trust.

We need a new generation of business leaders, a group with the courage to do things differently. People, I hope, like you.

It's a noble challenge that will have an impact on the welfare of many generations here and around the world.

That's the challenge I want to talk about today.

It is, I think, a more fruitful use of our time this morning than trying to analyze the recession and call its end. There are quite enough experts doing that just now. Isn't it remarkable how little they agree.

Depending on who you listen to, the recession is over and only just beginning; it's going to be as shallow as we all hoped, as deep as we feared. It's bath shaped, it's the shape of a hockey stick, it's a W. Take your choice.

As for the banks, barely have we digested the multi billion profits of Goldman Sachs and Barclays, than we learn of the multi billion losses at Lloyds TSB.

I mean no disrespect to the excellent professorial team of the Kemmy Business School when I say I don't think anyone really knows.

So as the effects of a banking crisis continue to spread into the wider commercial world, as companies face ruin from the collapse of credit, as people are plunged into despair by being thrown out of work, let's talk about what we do know, and how we can find a remedy.

Let's talk about the breakdown of trust in business and in business leadership.

The crisis has not yet passed for capitalism; it will – but for capitalism to be restored to the healthy model in which we believe, we must seize the opportunity to rebuild businesses in a better way.

What this crisis forces us to do – and this IS a good subject for business school – is to address the nature of business, what business is and what it can be.

Most modern societies give business considerable freedom to operate. What does business do to justify that freedom?

The crisis allows us to redress a balance – because undoubtedly areas of business were losing touch with the reality experienced by the world outside.

It invites us to create a business world in which the world can have future trust and confidence, to rebuild our business institutions on stronger and sustainable foundations.

What I have to say is not complicated. I am not going to get into collateralized debt obligations, structured asset backed securities and the other intricate concepts introduced by financial markets in pursuit of profit.

Rather, I want to examine more basic concepts to do with the way that business works and the way in which it relates to the world around it.

So I shall talk about the lessons of freedom and responsibility. About how business must earn freedom and sustain it by acting responsibly.

I shall explain why responsible behavior is central to business strategy.

And I shall suggest that *we* judge business leaders by wider criteria than profit...and that *they* accept accountability for the impact their actions have on society.

There is another excellent reason for speaking on this topic here, for the social accountability of business was one of the life-long principles of the man after whom this business school is named.

Jim Kemmy, Labour politician and lord mayor of Limerick, left school at 15, became a stonemason and worked for a while in the United Kingdom.

He returned to Ireland in 1960 and became involved in the trade union movement in the building trade, where he gained a reputation as a tough but constructive union representative, who understood the need to promote business and industry.

Jim Kemmy was pro-business so long as it operated with ethical standards and within a social economy. It's a view shared by the business school named after him. Kemmy seeks to serve the needs of both business and the wider community.

Let's take that mission as the starting point for a discussion of what businesses do – and the effect that they may have on society.

Businesses exist because of the propensity of human beings to engage in a division of labour. Adam Smith, in *Wealth of Nations*, described the 18<sup>th</sup> Century pin factory that allowed more efficient production when individuals divided between the tasks required.

Adam Smith's pin factory long ago developed new lines – or disappeared. One of the things that businesses do is innovate, because if there is a better way to make something, or something new to be made, they will work out how.

So businesses make things more efficiently. They create wealth that spreads beyond the business itself. They provide employment that brings money not only to the people who work for them but to the people with whom those workers spend their wages.

They bring us life changing advances, through research, discovery and innovation. That ability to innovate – whether in technology, management, products or services – is central to their survival. The benefit for society is that it brings us new sciences and technologies. Without companies, without business, we would not have enjoyed the benefits of that innovation.

I spent many years with Unilever, which had its origins in the Lever Brothers soap company. William Lever, that company's founder, described a real social purpose to his enterprise in Victorian Britain. It was, he said: "To make cleanliness commonplace; to lessen work for women; to foster health and contribute to personal attractiveness, that life may be more enjoyable and rewarding for the people who use our products." It was a remarkable vision in 19<sup>th</sup> century Britain.

Yet businesses were not created to be moral beings. They might operate in ways that we might regard as moral or immoral, but their primary purpose was the creation of wealth. Division of labour and the limited liability company – in which investors could come together to share risk and reward – were means to that end.

William Lever is interesting because of his far-sighted view of the purpose of his business and the way in which his factory treated its workers. He lived at a time when the fabric of society and the forces in society were very different from today. There was little or no state-funded social provision and many businesses operated in appalling conditions. He believed he had a moral responsibility to help, both through business and his personal actions.

He built a 'garden village' for his workers at Port Sunlight, on Merseyside. He introduced pioneering initiatives such as a shorter working week, sickness benefits, holiday pay and pensions. He made significant progress in health and safety initiatives. He built an art gallery for the employees.

He understood that it was in the interests of his business to act in this fashion. He said: "The truest and highest form of enlightened self-interest requires that we pay the fullest regard to the interest and welfare of those around us, whose well-being we must bind up with our own and with whom we must share our prosperity."

This idea of "enlightened self-interest" is an early recognition of the value for business of engaging properly with society, of making not just a moral case, but also a business case for that engagement.

William Lever was not alone. This was a period when we saw similar, far-sighted social involvement by, among others, those great chocolate dynasties, Cadbury, Fry and Rowntree.

But the reason we tend to think of these is that they were exceptional.

So companies were social constructs with strengths and weaknesses. I have outlined some of those strengths - innovation, economic growth, international development, the spread of prosperity. I believe we are all aware of the weaknesses – business failure, exploitation of workers, indifference to their effect on society and the environment.

These weaknesses were kept in check in two ways:

The first was through incremental legislation and regulation, often in response to corporate failures and misdemeanours.

The second was through the accepted norms of ethical behaviour the company derived from the society from which it had evolved, typically reinforced by institutions such as the church.

Let's not run away with the idea, however, that these institutions acted as any brake on some of the worst excesses of capitalism.

These norms no longer prevail – alongside the rise in individualism, mobility and diversity of lifestyles, the 21<sup>st</sup> century has seen an increasingly educated, less deferential society, a decline in the role of formalised moral codes of social behaviour, a fragmentation of traditional community structures and the emergence of self-defining communities of interest.

There has also been an explosion in the interaction between different societies on a scale unimaginable to our forefathers.

The impact of companies has grown out of all proportion to what could have been envisaged in the eighteenth and nineteenth centuries – on society, as well as on individuals. Business has been the great engine of globalisation, crossing national borders, creating multinational structures, moving towards the single market that we begin to see today.

So businesses have a huge effect on the world. They turn millions of consumers, employees, investors and citizens into players in global economic activity and growth. It is estimated that more than one billion people have been able to afford to buy a manufactured product for the first time in the last 10 years. In the coming decade we expect to see another billion consumers created. Consumer spending power in the emerging economies will rise by around \$4 trillion to more than \$9 trillion.

We talk about improving standards of living and bringing people out of poverty. These will be the longer-term effects.

But I am very ready to acknowledge that, in the short term, globalisation has led to greater inequality – with a widening gap between the haves and the have nots – and damaging environmental impacts.

The two sides of the argument are well rehearsed. On one side of the balance sheet we have the benefits of goods and services, work, wealth, environmental protection, access to clean water, food, shelter and energy, the creation for individuals of higher standards of living and quality of life.

On the other we see a degrading of the environment, the use of finite resources, a concentration rather than a spreading of wealth, short term profiteering rather than long term building and sometimes dangerous products. Traditional societies are disrupted, peoples displaced and workforces exploited. There is pollution, deforestation and climate change.

I believe the financial crisis has brought into sharper focus the harmful effects of business, and called into question the values by which much of business has operated.

So how do we get business operating in a more consistently beneficial fashion?

The simplistic answer is regulation. In America, the US Treasury Secretary wants the government to have tighter control over the financial community.

In Britain, the Financial Services Authority is also recommending stronger rules.

In Europe, the talk now is of a super regulator and new rules for financial entities of all shapes and sizes.

Many financial institutions will object to this level of regulatory control. But the level of recklessness that we saw in financial markets makes it difficult to defend the old system.

In the words of Hector Sants, the head of the Financial Services Authority in the UK: "A principles-based approach does not work with individuals who have no principles."

When businesses use freedoms irresponsibly and in an unaccountable fashion, it is inevitable that governments will curb those freedoms through regulation. Indeed, society will demand it.

But I don't think regulation is the whole answer. I think it will be hard to make it work in practice and I think it ignores the most important point of principle.

On practical grounds we risk removing the flexibility that business requires. And it's hard to apply meaningful regulation on an international scale. There are already arguments about where a super regulator should be based.

But more important still is the principle. New regulation should not let people off the hook for their reckless behaviour.

When you have regulation, the temptation is to look at the rules and resolve to work – just - within them. It leads to a philosophy of "what can we get away with?" But just because something is within the rules, doesn't make it the right thing to do.

If we were ever in doubt, we saw that in Britain this summer, where politicians attempted to justify outrageous misuse of taxpayers' money on personal expenses because it was "within the rules".

By concentrating on new legislation, on coercion, we absolve business from the need to think about how it acts. The question should not be: is this legal? But: is this right? When the accounting profession asked itself the question "is this a true and fair view?" this was a higher standard than mere legality.

Regulation gives directors who run companies the chance to sit on their hands and say: we were told we were acting legally. Better if they asked themselves if what is going on is right.

So regulation cannot be a substitute for individual responsibility – a commitment to explicit values and transparency of performance is required.

If you run your business on that basis, you learn important things about it – from the public, from your customers, from your own staff. When a company begins to gain a reputation for treating its workers badly, for abusing the environment, for reducing the quality of its goods, it comes under public pressure.

We didn't see that public pressure before the collapse of the banking world because banks operated in such an arcane way that the public had no idea what was going on.

Nor, it transpired, did the bosses who ran those banks.

And if companies that behave badly provoke a hostile reaction from customers, so those companies that behave well will encourage the trust and approbation of the public.

That came home to me more than 10 years ago at Unilever, where we worked hard to address the sustainability of fish stocks. We were one of the biggest buyers of white fish, with a direct interest in sustaining supplies. We began to switch to alternative species, persuading reluctant customers to adapt to new tastes and textures.

The national fishing fleets with which we worked were used to netting the older, dwindling stocks. They struggled to change practices and meet our needs. At that point, it would have been relatively easy for us to switch suppliers. But to do that would have put the old fleets out of work. We decided it was in the long terms interests of overall sustainability to keep those fishermen involved.

In debating the right way forward we put ourselves at the centre of a complex equation involving our commercial interests, the world's environmental interests and the region's social interests. We worked with the Marine Stewardship Council and the World Wide Fund for Nature to find common ground for the long-term benefit of all. I look back with some pride to what I believe was a model initiative.

And at its core for Unilever was enlightened self interest: "No fish – no fish fingers".

But there is a still more important initiative that companies must take for themselves. Business leaders need to acknowledge what's gone wrong and move to rebuild trust in business. They have a particular responsibility and opportunity to take the initiative. They must hold themselves to the highest standards of accountability.

Trust is not a property that can be bought. It is a quality that must be earned. There are times in life we may take people on trust, but we rarely trust them again when they let us down. Trust departs on a fast horse and returns, if ever, slowly on foot. We must learn to trust on the evidence before us. This is how businesses rebuild trust – brick by brick.

That may be a slow process, but it is also a rewarding one. It is easy to talk of trust, rather more demanding to operate by principles that embody it. But it is a great thing to build a business with real values.

What are the principles that encourage trust? There is a simple one. It is embodied in all the great religions of the world. It's the idea that we do unto others as we would have them do unto us.

And if some feel it uncomfortable to look to religion for guidance, we can look back to the "self-interest" identified more than 100 years ago by William Lever.

In other words, it makes sense for businesses to behave better.

They should behave in a socially responsible way because it is absolutely in their longer-term commercial interests to do so. For a business to be sustainable in the long term it needs a properly functioning society around it. Intelligent business leaders realise that they share responsibility for building and maintaining that society.

What do I mean by social responsibility?

Well, it's more than contributing to charity or engaging in other acts of philanthropy.

Rather, it has to be a core value of the business, a central tenet that affects the way a business works. When companies invest for the long term in the productive capacity of an economy, they can fuel a virtuous, stabilising circle of economic activity.

Businesses should be explicit about these values and ensure that all employees understand that they will be judged on their contribution to this core value of social responsibility as much as they are judged on such things as production and sales.

Sometimes the benefits of behaving properly are brought home to you in graphic form.

Once you do engage, it leads you in interesting directions. Some of them are uncomfortable. Businesses start to think more about those issues such as care of the environment and husbandry of finite resources. They wonder about issues such as part time working, maternity and paternity leave and early retirement. They begin to debate the nature of the contract between employer and employee, rather than treat it merely as a matter of law.

And if businesses are to be truly responsible, they must be open and transparent. When they fall below the standards we expect of them, they should admit it. In that way they will build trust.

Once we start to apply those core principles in a business, we place an onus on people to act in a certain way. Their actions are not driven merely by regulations – by obedience to rules introduced from outside – but by the values, the principles, of the business set from within. In other words, they do the right thing because that is how the company works.

Don't think this is easy. Commercial decisions do not necessarily have obvious and indisputable social benefit. There are tensions between commercial opportunity and social impact. Tough trade-offs have to be made. These issues are rarely clear-cut or

straightforward. There are sometimes no right answers. If, in hindsight, we get some wrong, at least let us make them with social responsibility in mind. Then we must find it easier to say sorry – quickly – when we make mistakes – and easier to learn.

So let us have companies set out their values and standards of behaviour, apply them in a way that is consistent with their culture, and then be prepared to explain why they take the actions they have. Trust is about being consistent in how you apply your values. Lack of trust comes when you say one thing but do another.

You have only to look at the banks to see what happens when you don't behave in this way. Banks stopped acting with any values that could conscientiously have been laid down by a socially responsible institution. Most were not immoral in the sense of dishonest – but they were reckless and they were greedy and they misled their customers and shareholders.

Perhaps we will now understand that there is a difference between making money – which is certainly what the banks were doing – and creating sustainable wealth that is ultimately beneficial to society.

If you had asked these banks about their attitude to corporate social responsibility they would have demonstrated any number of philanthropic initiatives and charitable activities. But their core operations had become so complex, so profit driven, so amoral that they no longer operated in a way that showed true social responsibility.

Above all, they were interested in the short term, in trading not building.

That brings me to one of the great tests of true social responsibility and a yardstick by which we will increasingly judge businesses.

Bankers became traders looking for short-term profits rather than builders creating long-term value. And they measured bonuses against gross revenue without understanding the quality of those earnings or whether they were sustainable.

To earn our future trust, businesses will have to demonstrate long term commitment. The innovators, entrepreneurs and manufacturers who have developed our greatest companies were all builders. Traders are the investors who look to quick money and will risk much to get it. Building a business takes time and looks to the future. Trading promises instant returns.

Well now is the time to start valuing the builder mentality.

You help do that by creating a system of rewards that looks to the long-term. Compensation has been at a level that is beyond the imagination of many in society – and those who can imagine it find it morally unacceptable.

Let us now connect compensation to long-term value creation rather than the short-term generation of profit. Let us cut back on short-term bonuses and have business leaders take their benefits in their company's shares, where there is a clear relationship to that longer-term value.

In looking to the future we look naturally to the next generation, to people like you.

I am proud to have spent my life in business. I want business to give you good reason to spend your lives in it.

It will only do that if we rebuild trust. We have come to the position where people literally do not trust their high street bank. People have become suspicious of business as a whole. That trust has to be won back. It will take time.

It is time for business leaders to understand that customers are citizens who live in communities. And that if their business does not behave in a way which is respectful of these communities, customer-citizens will withdraw their support. This is enlightened self interest.

There will still be big rewards for successful business people – but only in return for better leadership. We are looking for men and women who combine returns for shareholders with responsibility for social and environmental performance.

These must be leaders not only of their business but also within society.

Business works best when it has freedom to operate. It's time for business leaders to step up and show by their actions that they deserve that freedom.

This is the way of operating within society to which Jim Kemmy devoted much of his life.

It's a way of operating that ultimately promotes rather than inhibits business.

And it's a way of operating that businesses *must* follow – or they will discover that their freedoms to operate are curtailed and they won't be operating at all.

So this is the challenge for all in business, the challenge for everyone going into business.

We must study and understand the mechanical causes that brought us to financial disaster. But the mechanical causes are not the full story.

Rather we need to question the driving spirit of business.

And make that driving spirit one in which we wholeheartedly believe...a spirit in which we take pride.

[A video/ podcast of the lecture will be available on the KBS website later this month.]