

Managing In A Complex World

CAN BUSINESS SATISFY SHAREHOLDERS, CUSTOMERS AND SOCIETY AT THE SAME TIME?

Address by SIR JOHN BOND, *Group Chairman, HSBC Holdings plc*

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Chancellor, Sir Gareth, Ladies and Gentlemen, Good Evening. It is a great honour to be asked to be the speaker for this, the first Roberts Lecture. As possibly the least academically qualified person in the room, it is also somewhat daunting. It reminds me of the clergyman in the jungle who, when confronted by a lion, dropped to his knees and started praying. The lion immediately did the same.

The clergyman says to the lion, 'I didn't know that lions prayed'.

The lion replied, 'I'm not praying, I'm saying grace'.

In front of this audience, I feel rather like that clergyman!

We live in a complex world. The organisation I joined in 1961 operated in 18 countries and had a market capitalisation of 20 million pounds. Today HSBC has 7,000 offices in 81 countries and territories worldwide and a market capitalisation in the region of

US\$100 billion, or ú60 billion. And we answer to 330 regulators around the world. Caucasians are in a minority. One-in-six of my colleagues is Chinese, one-in-seven Latin American. I work in a truly multicultural environment which is a marvellous experience.

My theme tonight is reconciling the tensions between different participants in economic life. Within the world of business, we have to manage the interests of clients, shareholders and colleagues, and take account of the wider interests of society.

My colleagues and I have to manage the interests of 36 million customers, 190,000 shareholders from 100 countries and 175,000 staff.

Each of these constituencies have their own representatives: shareholders have the institutional investors and shareholder groups, staff have unions and associations, and customers have consumer groups, regulators, the media, and the NGOs represent wider society.

My job is to reconcile the conflicting interests of these groups. Ironically, I would say that historically our customers have probably been the least represented.

And seen from the wider perspective of society, the relationship between the private sector, the public sector and the academic world is a vital one for the nation to get right. These inter-relationships are ones where the frontiers are constantly changing. The critical thing in my judgement is to recognise that we can improve relationships between these sectors. And the only way to overcome

any barriers is through open dialogue.

So if you will forgive the nerve of someone who has spent their entire adult life simply as a businessman, pursuing a theme of greater connection, let me start with three thoughts.

First, the creation of the limited liability company was probably one of the greatest examples of enabling regulation in economic history allowing, as it did, risk to be shared by shareholders and creditors instead of individuals only. The Joint Stock Companies Registration and Regulation Act of 1844 and its amendments in 1855 and 1856 may not have the romance of Stephenson's Rocket, but its effect was as profound as any invention of the industrial revolution.

Second, it wasn't a businessman who said 'the worst crime against working people is a company that fails to operate at a profit'. It was a trades unionist, the first president of the American Federation of Labour, Samuel Gompers.

And third, what if Henry Ford had stopped working when he had enough money to buy two houses and educate his children? Would the world be a better place?

We live in a world where business is under attack from many quarters. There are sections of our society that do not trust business. You can see it in the protests in Seattle, Genoa and Davos. You can hear it from some politicians who would like to micro-regulate business. And you can read about it in the papers, whether it's Enron or Worldcom. And I have to say that some of the specific criticisms are valid.

Just as a small percentage of the population is in jail, a small percentage of the business community is not capable of distinguishing right from wrong. But the risk is that you then argue from the particular to the general, and tar all business with the Enron brush.

No-one argues that because the occasional academic falsifies their research, that all research should be stopped. Or because a politician takes a bribe that we should ban politics.

Similarly, it is not sensible to assume that there is anything inherently wrong with business, or with profit.

Of course, capitalism is a human endeavour and therefore subject to human frailties. If I may paraphrase Winston Churchill on democracy, capitalism is the worst form of economics except all those other forms that have been tried from time to time.

Many of the recent corporate excesses that have taken place, have taken place in the new economy. And many have taken place in companies with dominant personalities as Chairman or CEO. In HSBC's judgement, personality-led companies are vulnerable because they are obviously subject to the demise of the personality either literally or metaphorically, and because individuals are seldom infallible. How much better to have a company with an institutionalised set of values, which can draw on the combined talents of a team of people, and the wisdom of the ages.

The form of capitalism practised by the Carnegies and Fricks of the industrial age was, by modern standards, rough and sometimes cut-throat. And as a result, in the twentieth century, we saw the rise of the labour movement to redress these excesses, which, perhaps, in turn led to excesses on the other side in the 1960s and 70s.

For much of the twentieth century, the debate was between communism and capitalism. With the fall of the Berlin Wall, capitalism won that debate decisively. Yet ironically at the time of its greatest triumph was sown the seeds of its greatest challenge. Capitalism must now prove itself in absolute terms.

These are never black and white issues. Victorian capitalism included such enlightened thinkers as Lord Lever of Port Sunlight and Robert Owen.

And a so-called robber baron like Vanderbilt may have made 14 cents for every barrel of flour that travelled on his railroad, but in the process he reduced the cost of that barrel to the consumer by US\$2.75.

The embodiment of modern capitalism, Bill Gates, who is criticised in some quarters for his wealth, gave US\$1.44 billion in 2000 to vaccinate children and fund research into killers like HIV/Aids, Malaria and TB in developing countries. That is one quarter of what all the industrialised nations combined gave to the developing countries in this area.

Business is far from perfect but it brings very real benefits to society. Theodore Roosevelt said, 'Business has to prosper before anybody can get any benefit from it'.

Let me state the obvious. Without the private sector, there would be no public sector in a market economy.

People depend on the jobs business creates to earn the money to live well or otherwise. And please do not confuse living well with conspicuous materialism.

Capitalism is not just about buying into global brands; it is about the green revolution that has done more to prevent starvation than anything else in the history of humanity; it is about lifting hundreds of millions of people above the poverty line - which I have personally witnessed in Asia - and it is about giving people access to the best that we produce in our society, whether that is literature or

lightbulbs.

At its best, capitalism is about choice. In a market economy, it gives people the freedom to choose how to spend their surplus income. It enables them to look after their families and educate their children - to give the chance of a better life for future generations.

It's the choice between people spending their own money and the government spending their money for them. Which of course leads to a very legitimate debate about what should be done in the public sector and what should be done in the private sector. My belief in freedom and experience of living in six different countries points me in the direction of allowing people to make their own choices as much as possible.

And, of course beyond work, capitalism looks after people through their pensions which are, of course, paid for by business, both by way of taxation to the government, and by occupational pension schemes provided by companies.

In future, individuals are going to have to depend more on saving for their own pensions, which means they have to have the ability to make investments in corporations that make respectable profits. If the corporate sector produces low shareholder returns, inevitably pensions will be low. It is a paradox that low prices for consumers may provide low pensions for retirees.

This is particularly relevant to the UK at the moment. The cost to a company of funding pensions with a fixed salary or defined benefit scheme is about 25 per cent on top of salaries: a defined contribution scheme somewhat less - the costs shared between employer and employee.

In most of mainland Europe, pensions are funded directly by government via taxation on a pay-as-you-go basis. This actually means contributions from current workers pay for current pensioners; a transfer of wealth between the generations. This adds a high "social cost" of 20-25 per cent in the form of tax. High, but with the demographic changes Europe faces, not high enough to fund the present level of pensions over the next 30 years.

If we look at labour costs, out of a total cost of a hundred, what people actually get directly in salary is 63 per cent in the euro-zone, compared to 75 per cent in the UK.

So if we move towards EU-harmonised regulation and UK business has to bear the same social costs as the euro-zone at the same time as it funds private pensions, then it will have a double burden.

The whole of the government tax base is dependent on a successful private sector.

People wouldn't be paying income tax and they wouldn't be paying national insurance unless they were employed.

And all the consumption taxes - VAT, petroleum tax, alcohol and tobacco - are all dependent on people having

money to consume.

Government itself and civil servants are paid out of the taxes from workers, sole proprietors, partnerships and companies.

In 2001-2002 the government's income and expenditure was balanced at around 390 billion pounds. The Inland Revenue contributed £216 billion - or 55 per cent - of which £170 billion came from people paying income tax and national insurance.

Customs and Excise contributed over £100 billion - or 25 per cent - almost all of which came from VAT, fuel, tobacco and alcohol duty.

And much of the remainder is derived from business directly, like corporate tax and business rates, or indirectly from peoples' income, like council tax.

So profits, out of which the salaries and taxes are paid, are the lifeblood of a market economy. And we have to be very careful that we don't make profits synonymous with rip-off in the modern world. One of the great attributes of a true market economy is that anywhere above-normal returns on capital are made will attract new capital and competition, and therefore reduce those returns.

Success is what secures jobs and taxes and pensions. So we need a healthy private sector. And not just healthy against domestic competition, but healthy in international terms because we live in an interconnected world.

And because however much we argue about globalisation, you cannot disconnect an interconnected world unless you want to introduce an iron curtain. And for most of us the iron curtain has gone out of fashion.

Why are there interest rates? Because there is a shortage of financial capital. And so it is important for any economy that financial capital is employed effectively.

Capital tends to seek the best returns. In a closed world it would find a home and stay there. But in an open globalised economy, capital is much more mobile. And this can cause painful changes as well as beneficial ones.

These changes are something that Sheffield has particular experience of. The shift from manufacturing and the changes in the steel industry have been painful, very painful. And business needs to be sensitive and aware of its responsibilities to the communities in which it operates. That has not always been the case.

But this does not mean that business can or should stand against the tide.

The economic history of the second half of the twentieth century was, in large part, about the internationalisation of manufacturing and we are now seeing the same process at work in the services sector.

The hard reality is that we either watch jobs disappear to more efficient competitors, or we anticipate the challenge and plan sensitively for it.

There's an inexorable rule of accountancy. One person's income is another person's expense. Whenever you see a company or an individual reducing their expenditure, you can be certain that it is having an equal and opposite effect on someone else's income.

Businesses, unlike political parties, are voted on daily not every five years. Customers, shareholders and colleagues can vote with their feet every day.

If customers think they are getting a raw deal at the expense of shareholders, they will go elsewhere. If shareholders do not get a satisfactory return, they will sell their shares and invest elsewhere. And you need the best possible colleagues to run a world-class business, which means looking after their interests because talented people can go anywhere. Your best assets do indeed walk out of the building every night.

In the eyes of some people, executives like me are fat cats because we are very well paid compared to most of our colleagues. And it is true that I am very well paid by most standards and I feel absolutely privileged to do this job and work with a great group of people. But on a personal note, last year I spent 12 weekends at home, the rest were committed to the business of HSBC. I spent over 100 nights in overseas hotel rooms. Sometimes people think executives spend most of their time on a mobile phone in Barbados; the reality is not quite like that.

HSBC's top team carries responsibilities to 175,000 colleagues and their families; to those 36 million customers; and to, perhaps, 17 million people in Britain who have an interest in HSBC's performance through their pensions or hard-earned savings, including many of the people in this room.

And it carries wider responsibilities to society. In Sheffield, HSBC is the largest private sector employer. And we work hard to support our community here. We sponsor the Sheffield North East Education Action Zone.

We have given support to 33 schools in Sheffield either through the Education Action Zone, through supporting Specialist Colleges, through our support of Young Enterprise, through scholarships, through School Banks, governors, or through the provision of corporate equipment. None of this could happen unless HSBC is successful.

So if I do my job well, we all benefit. And if I don't, then these people will suffer, and so should I. There are all too many examples of companies that have taken the wrong path and whose shareholders, staff and customers have paid the price.

In fact, it is the nature of companies that they evolve or die. There is only one company remaining in the Dow Jones Index from the original thirty. And the FTSE-100 is almost unrecognisable from when it started 18 years ago, with less than a quarter of the original 100 companies left.

Generally, companies have far shorter lives than humans. Around 60 per cent of all new businesses die within three years.

So there is a market for management simply because good management creates wealth and bad management destroys wealth. However, it is a huge problem and major embarrassment for business that people who destroy wealth can get rewarded inappropriately.

But it does seem reasonable that those who create wealth are rewarded. Those people who do create enduring businesses are creating wealth for society as a whole: the Henry Fords, the Bill Gates of this world. You need people that have the talent, the drive and the sheer stamina to go on and develop a business and to become billionaires. These are people who can have an extraordinarily valuable role to play in society: creating jobs, creating wealth and helping the pension industry - which is another way of saying helping people enjoy their retirement.

Please do not think that I am arguing that all billionaires benefit society. I wouldn't include those who speculate at the expense of the taxpayer or those who hold their shareholders to ransom. But most successful companies are created by someone providing goods or services that people want and will pay for. I think, for example, of the late Sam Walton of Wal-Mart; he has lowered the cost of living for millions of people in the USA and, increasingly, around the world.

So far I have argued that the prime responsibility of business is to make a profit. But today business has responsibilities that are far further reaching than simply a narrow definition of profit. It is not just making profits, it is how you make them that is important.

Business needs to be accountable to society. As well as its financial performance, its social and environmental performance is rightly under scrutiny as never before. Which is why companies like HSBC participate in indices like the FTSE4Good and the Dow Jones Sustainability Index - because we want to be measured against the best.

Today's generation of business leaders have a different mindset to previous ones. For many years businesses were organised along military lines. The present generation of business leaders is the first that hasn't had direct experience of war whereas many previous leaders' cast of mind was military: you can hear it in words like strategy, tactics, divisions, officer, personnel....

Business then was probably more narrowly defined and more hierarchical. Today I do not see many capitalists red in tooth and claw out there. There is more emphasis on teamwork and on areas like corporate social responsibility. Most businesses are well aware of their wider responsibilities to society.

Big business certainly needs to de-mythologise itself.

Distrust of business seems to be at an all-time high. But a business is not some abstract legal entity. Companies are composed of people with feelings and aspirations just like everybody else. And most people want to do something they are proud of.

I talk to my colleagues and they care; they want HSBC to be respected and trusted, they want to work for an organisation that is successful and knows how to share its success with those who are less fortunate.

So yes, we need to point out the connection between the £32 billion raised in Corporation tax and the £30 billion spent on schools in the UK last year.

And we also need to stand up as a bank and say that there are certain types of lending which we will not do, that we will only finance sustainable forestry, that we do not want to finance the arms trade.

And on the positive side, if you look at our lending record, we need to be able to say that we made a real difference, that we made things possible, that we made things happen.

And most of all we need to make the connection between people's everyday lives and business. That business in its own way makes things better for people.

And those of us who manage businesses need to engage more, to explain more and to face up to what are, often, legitimate concerns.

A complex world creates choices, sometimes hard choices. Let me give you an example. At HSBC we have an issue that we spend much time thinking about. We have transferred some of the back-office work of our banks in the UK and North America to our operations in India and China. We do this because technology now enables us to perform the same work at a significant cost benefit and, in most cases, increased productivity.

But because, more than ever, business is accountable to society, we are criticised, on the one hand for exporting jobs from developed countries and, on the other hand, for exploiting workers in developing countries.

We believe that neither criticism is true. Ultimately, if we wish to remain successful, we must remain competitive. Our customers and shareholders benefit from us improving our efficiency. And the only way we can give employees long-term security is by being successful. If we are not successful, another bank will take our business away and none of my colleagues' jobs - or mine - will be secure. You only have to look at the experience of some sectors of British industry to see how this works.

Of course, you have to manage the changes very sensitively. So we keep our employees informed, we talk to the union and we do everything we can to find other work for my colleagues, and where necessary to reduce our staff through natural attrition. As a result, so far we have done this with no major redundancies in the UK.

The second issue is the charge that we are exploiting workers in developing countries. We reject that absolutely. We are creating high-value jobs in developing nations where these sort of employment opportunities are vital. In our 140-year history, we have literally created the banking system in many countries. And we believe that we have played an important role in the development of many economies.

We are excellent employers, we provide state-of-the-art facilities and pay excellent market rates for talented employees. They are mostly delighted to work for HSBC. We are not fly-by-night operators. We have been in China and India for more than a century and we manage our businesses there for the long term.

So far I have talked about business as if it were solely responsible for wealth creation. Of course, that is not accurate. Perhaps there is some truth in the old adage that "prosperity is something that businessmen create for politicians to take the credit for". But business is a necessary, but not self-sufficient, condition for wealth creation in a market economy.

I would identify two other vital components in the process: regulation and intellectual capital. Regulation in most fields of human endeavour is vital. And like good medicine, even if it tastes awful, no-one is against good regulation.

The history of government itself creating wealth is distinctly chequered, however government does set the scene for wealth creation. What government does is provide the framework, by its regulatory choices, to make it possible or less possible for business to succeed.

That starts with property rights, which we take for granted in developed countries, but which is a major barrier to development in some countries.

Beyond the enabling legal infrastructure, regulation is needed to shackle, wherever possible, the Al Capones of the corporate world. But regulation that's predicated on the fact that we are all Al Capone is not helpful.

The modern City of London as a financial powerhouse was effectively created 22 years ago by removing regulations in the form of exchange controls, which allowed capital to flow freely in and out of the country; and when the 'big-bang' deregulation of the stock market allowed the creation of a competitive securities market of worldwide significance.

Unfortunately, regulation does not usually ebb and flow. Generally, it just flows. And it's a very difficult political judgement to create regulation that allows the best of free markets to flourish and restrains the excesses.

Regulation is rarely straightforward. In many cases, it has the law of unintended consequences attached to it.

The eurodollar market, of which London is the centre,

was gifted to Europe by American regulation - regulation Q - which put a limit on interest rates on deposits in the US.

The Common Agricultural Policy is an example of what happens when producers are disconnected from consumers by regulation. I saw some research this month that pointed out that the average EU cow is subsidised to the tune of two US dollars a day, giving them an income greater than half the world's population.

This is not an argument for avoiding legislation; it is a warning that legislation must be carefully thought through or its effects may be perverse. In this country the government's solution to making the small business banking sector more competitive involved a form of price regulation. There are few, if any, examples of price regulation that do anything other than decrease competition.

Good regulation needs government to be sensitive, and it also takes business to be responsible. That means better communication between the two. Failure to do so means that we are failing in a fundamental way. How can Hong Kong plan, design, approve, and build a brand-new world-class airport whilst we are still arguing about whether we should have another runway at Heathrow?

Too often, there is a gap between government and business. So both sides need to work harder to understand each other.

The other vital part of the process is in your domain. Intellectual capital is certainly not the preserve of business. Clearly, the academic world creates, husbands and improves the nation's human capital. Although you may not see it this way, HSBC is a major consumer of education. We employ graduates from hundreds of universities from around the world - our international graduate recruitment training course this year alone has 40 different universities represented - and so we have a unique perspective to observe the outcome from tertiary education systems of different countries. Yet we do not engage with you enough. We should be looking to talk to you more; we stand to learn a lot.

The productive use of intellectual capital is not by any means the sole function of the academic world. But it seems to me that failure to use that capital productively where it could create jobs, wealth and security is an abrogation of responsibility.

There would be no penicillin without the work of Fleming and other scientists. But it took the American chemical company, Pfizer, to work out how to mass produce it and save millions of lives.

I've worked in six countries on three continents and my experience is that the gulf and the suspicion between the academic world and the business world, and the business world and government is probably greatest in this

country.

To change that, you need a much better flow of people between the public and private sector, from academia to business and vice versa, something that doesn't happen here as much as it should. If I had to point to an enduring competitive advantage that the USA has, it is that both the academic and political classes frequently have direct experience of business, and vice versa.

And I would say that as a reasonably direct consequence, the USA's economy is stronger. In the last ten years, Gross Domestic Product for the EU as a whole has risen by 20 per cent. In Britain, the figure is 30 per cent. In the US, the growth was almost 40 per cent.

Of course, some institutions have recognised the problem and I should say that the University of Sheffield has provided some very distinguished exceptions to this thesis. Your Chancellor, Sir Peter Middleton, has served with great distinction in the public sector, the private sector and academia. And I am full of admiration for Gareth Roberts who has long shown the ability to bridge the worlds of academia, business and politics also with great distinction.

HSBC has long supported educational projects around the world. We are involved in over 10,000 different projects. And one of our aims is to bridge the gap between bank and gown, whether by promoting business education through initiatives like the Personal Finance Education Group, or by supporting Young Enterprise which introduces business to schoolchildren, or by sponsoring Professorships of Innovation.

In a very small way, I've also attempted to do that my-

self as Chairman of Heads, Teachers and Industry, an organisation that tries to bridge the gulf by putting teachers into business and businesspeople in schools - at the moment we have two headteachers on work placement at HSBC and we have plans to put business people into schools.

Earlier this year, I spent a morning teaching in a school. Although, sadly I fear that while I learnt a lot, the pupils learnt very little!

So let the academic world, the world of government and the business world come together in a much more sensible way. Rather than the academic world not wanting to sully its hands with business, government being suspicious of the motives of business, and business feeling that government is not interested in a thriving private sector.

We must all recognise that we are mutually dependent. And that by working together and understanding each other's needs better, we can all do what we do better and expand the horizons of people in government, academia and business in an exciting way.

It is surely within the capabilities of people through intelligent and rational debate to succeed in this. Britain has led the way in so many areas. There is no reason why we should not be able to harness our resources - all our resources - to make sure that we work together in a way that makes the most of our undoubted strengths. More than ever in a borderless world, we need to remove our own internal barriers to success. And by so doing, improve the lot of all British people.

Doing The Right Thing

VALUES-BASED LEADERSHIP IS NOT AN OXYMORON IN CORPORATE AMERICA

Address by HARRY M. JANSEN KRAEMER, JR., *Chairman and CEO Baxter International, Inc.*

Delivered to Chicago Executives' Club, Chicago, Illinois, October 15, 2002

Certainly, the corporate scandals of the last year have caused each of us to ask a lot of questions - where does it end? Who's next? How could this have been avoided? Where does the buck stop - who should be held accountable for the action or inaction of a corporation, its leaders and its board of directors? And, is it realistic for us to expect that the companies in which we are employed and invested operate in a manner that is not only ethical, but driven by a common set of values?

While it's not the first we've seen of corporate scandals, the breadth and depth of recent scandals leaves many of us speechless. And whether fair or not, it is clear that the leadership and ethical and ethical standards of every leader and every corporation are on the line.

Today, I'd like to offer a few of my personal observa-

tions on how these scandals related to corporate governance, corporate integrity, and business practices can be avoided, and how we all must be held accountable. I have some strong opinions on these topics, and these opinions come from my experiences over the last 20 years. What I would like all of you to do is to think through as leaders, what do all of us need to do to set an example?

Let me start by stating how proud I am to be part of the Baxter team, in a company and an industry that has a profound effect on the health and welfare of millions of individuals around the world. Our products and services are used in the treatment for thousands of patients with critical medical conditions that occur from traumatic injuries, immune disorders, kidney failure, cancer, as well as hemophilia.

