

Issue date: June 2004

A newsletter for the Financial Services Industry

• IFS lecture London City Prestige Lecture • Drapers Hall • 6th April, 2004



Corporate Governance in Banking - Where is the Shame Today – Who are the fools?

Mr Michael Kirkwood, CMG, FCIB - MD & Country Officer UK, Citigroup

Mr Kirkwood, the UK Corporate Officer for Citigroup Inc. is business head for Corporate Banking and Citibank's senior UK customer executive. Mr Kirkwood, who is also President of the Institute of Financial Services, delivered the *ifs* London City Prestige lecture on the 6th April 2004 at Drapers Hall on '**Core Values, Corporate Governance & Consolidation in European Financial Services**'. Aqute attended the lecture and provides a summary of the key points from his presentation below.

Quoting the proverb "fool me once, shame on you, fool me twice, shame on me" Michael Kirkwood used this as an analogy to discuss how corporations and banking institutions are taking the role of Corporate Governance more and more seriously. The real question for us he says is "Where is the shame today?"

John Austin, a philosopher of language at Oxford University at the turn of the century said it is a mistake to think words only *describe* things, words also *do* things such as the commitment when we say 'I promise to pay...' This is a pledge to pay not a prediction and therefore sets an expectation with customers.

Core Values

The last three years have been difficult for the financial services industry. A number of our industry practices have come under sharp scrutiny from government, regulators and especially investors. However regulation is not enough. As Alan Greenspan says '*rules cannot substitute for character*'. Doing the right thing needs to be a standard we set ourselves. Day to day decisions required of corporate management need to be governed by a personal code and values which managers bring to the table.

Corporate Governance.

Mr Kirkwood suggests that there are three core values on which public confidence depends: Integrity, Independence and Accountability. **Integrity** does not just mean honesty, it is a function of not only what we do and but also what we don't do: saying "No" to profitable but doubtful business. This is what Americans mean when they say "**walking the walk, not just talking the talk**".

The second core value is **Independence**. Acting in the customer's interest in a truly impartial and objective manner. Firms should also consider going beyond the Higgs Report and have a board committee composed entirely of outside directors.

The final core value is **Accountability**, by which he means the reporting structures and framework that allow corporates to practice the other two values. As already suggested, having a Legal and Compliance Department does not get you off the hook. He recommends a Business Practices Committee that sets policies and interacts directly with business groups to surface potential issues and provide rigorous scrutiny of business practices to ensure they reflect the organisation's ethics. At Citigroup there is a "**blood oath**" that requires the most senior management to hold onto 75% of their stock or options for as long as they run the company.

We have come to learn in the last three years that reputational risk is every bit as important, if not more so, than credit risk. One of the most far reaching changes we have seen in recent years is the growth in the number of constituencies to whom bankers are accountable. Once this was simply felt to be employees, clients, shareholders and regulators, but of late, we now have to add many other stakeholders including local communities, pressure groups, non-governmental organisations, host governments, and media who have very different issues which may, in fact, conflict with traditional stakeholder issues.

Consolidation

Michael Kirkwood suggests that we cannot afford to ignore the forces of globalisation and the wider role we should be playing as greater interdependence binds countries and citizens more closely together around the globe. Not everyone shares this enthusiasm for globalisation. The GATT agreement for global trade is under attack as never before. Some critics advocate "compassionate globalisation".

In trying to adhere to Professor Austin's formula for practising what we preach, Mr Kirkwood believes a simple rule is to make every community where they operate, a better place. For example helping people help themselves through microfinance programmes.

An additional dimension to ethics and corporate governance is more market driven: companies with strong governance systems have outperformed peers in a wide range of settings. The Corporate Governance Rating System CGQ (Corporate Governance Quotient) which scores a company against

core evaluation metrics (such as Board Structure and Composition) has proven that there is a material difference in stock price performance between high and low CGQ companies.

The most difficult task of any major multinational is to create a single global culture, a task that necessitates the wholehearted embracing of diversity, something well beyond the capabilities of many corporations that have tried it. Firms whose growth has been driven chiefly through rapid acquisition frequently run the risk of ethical compartmentalisation. There is little doubt that consolidation trends will further complicate the work of bank regulators and supervisors. Citigroup are acutely aware of the hard work needed to encourage progress towards socially responsible business practices.

In conclusion

Quoting from Charles MacKay's observation that "men think in herds and go mad in herds, while they only recover their senses slowly and one by one", so it is precisely when we believe we are surrounded by "greater fools" that we are mostly likely to be fooled ourselves, not once, not twice, but continually. As Martin Luther King is famous for saying "We either prosper together as brothers or go broke together as fools". Mr Kirkwood concluded by saying he was a great believer of the City adage 'my word is my bond'. If our integrity can never be at question, we will have fulfilled the single most important responsibility we all have as Bankers.

About Aqute Limited

Aqute specialises in consulting to the financial services sector. Aqute management consultants have over 10 years experience in helping drive business change, business transformation and performance improvement with clients that are household names in banking and insurance.

For more information contact Angela Hakim: angela.hakim@aqute.co.uk or liz.thrussell@aqute.co.uk
To add or remove someone from the newsletter distribution list please reply to: info@aqute.co.uk

Disclaimer

The views in this newsletter represent the author's views on the events described herein and although every effort has been made to accurately describe them, may not be an accurate representation of the presentations given.

For more information,
please contact info@aqute.co.uk
500 Chiswick High Road
London W4 5RG
www.aqute.co.uk
t +44 (0)20 8956 2505
f +44 (0)20 8956 2504

