The future of leadership

By Jeffrey E. Garten
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The excesses of the 1980s and 1990s are behind us and the geopolitical environment offers challenges not seen since the second world war. To survive, managers must go back to basics.

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Predicting the requirements for successful business leadership over the next few years is a daunting task. After all, most of the world's most powerful executives - from Henry J. Paulson, Jr., chairman and chief executive of Goldman Sachs, to Lord John Browne, chief executive of BP, to Jorma Ollila, chairman and chief executive of Nokia, to Hiroshi Okuda, chairman of Toyota - face a change from the halcyon days of the 1990s to a harsher economic environment.

In meeting the challenges of a new era, global business leaders will need to do three things. They will have to preserve those leadership traits that have been effective for most of the period since the second world war. They must discard those that were too closely connected with the excesses of the 1980s and 1990s. And they should acquire knowledge, skills and new attitudes that will help them navigate the decade ahead.

None of this would be easy under any circumstances, but the task is complicated by several factors. For a start, the corporate scandals that have engulfed Enron, WorldCom and other companies have rocked the foundation of corporate governance. Everything about the way companies are overseen is being shaken up - including accounting and auditing practices, compensation systems, and the structure and composition of boards of directors.

There has also been an enormous erosion of public trust in the character of business leaders and their capacity to do the right thing by any of their constituencies - shareholders, employees, even customers - without government oversight. And there has been an equal loss of faith in the notion that financial markets are reasonably fair, treating ordinary citizens in a fashion broadly similar to the privileged few.

These issues will not fade away. After the Berlin Wall came down, the world started embracing an "equity culture" modelled largely on the stock markets of the Anglo-American economies. In continental Europe and emerging markets in Latin America, Asia and elsewhere, companies began shifting their financing techniques from a reliance on bank lending to a dependence on rising stock markets.

Deregulation, privatisation, pension funding, technological experimentation, executive compensation - all of these, in one way or another, depended on investors' and regulators' faith that equity markets were not just efficient but reasonably fair. It is too soon to say whether this culture is waning, and in any event it would be difficult to predict what could replace it.

But the prospects for expanding the equity culture have been damaged by corporate scandals and public disgust with business leaders on both sides of the Atlantic. For the first time in decades, chief executives will be forced to focus on these problems, in effect changing a good deal of their job descriptions.

At the same time, the financial system, the lifeline of all companies, is in the early stages of wholesale restructuring.

Global behemoths such as Citigroup, JP Morgan Chase and Merrill Lynch face pressure to reorganise to avoid conflicts of interest between their research and investment banking operations, and to reform certain underwriting practices.

Complicated financing techniques - from the structuring of off-balance-sheet assets to the increasing use of financial derivatives - are under scrutiny by governments. Indeed, we could be seeing the demise of the very idea of a universal bank selling everything from loans and underwriting to insurance and wealth management, not to mention a new wave of financial regulation.

While these changes occur - and they could unfold over several years - financial institutions are likely to be especially risk averse, frustrating the ability of companies to fund new investments.

How then can chief executives attain profitability? Amid low inflation and a hypercompetitive global marketplace, they must cut costs rather than increase prices. This is tough and unpleasant work, requiring roll-up-the-sleeves attention every day. It takes different skills from those needed to plan global strategies involving mergers, alliances and bold new strategic departures.

Finally, the geopolitical environment for business is likely to chill considerably in the foreseeable future. The prospect of war in Iraq and the potential consequences for stability in the Islamic world, including either soaring energy prices - or, under a different scenario, a collapse in the price of oil - is worrying enough for chief executives leading global operations.

Even if an invasion of Iraq were averted, the US-led war on global terrorism will be a fixture of the international landscape for years to come.

It could easily change political alliances and patterns of economic co-operation in trade and finance. It could raise the cost of doing business around the world, because of new security precautions for air and sea transport. It could add new risks to moving supplies, setting up businesses and employing foreign nationals. In these matters, chief executives will be operating in uncharted waters.

Changing requirements at the top

Many of the traditional elements of excellent corporate leadership will nevertheless remain central to the success of chief executives.

There will be no substitute for hiring, developing and retaining top talent. Leaders must balance vision for their organisations with effective strategies and the ability to realise them. Chief executives will have to juggle the roles of building teams, being part of them and providing subtle direction. They must develop organisations that do not stifle entrepreneurial behaviour among managers yet are centralised enough to manage risk and create strong corporate cultures. They will have to be excellent communicators within and outside their organisations. They will still need to become global in their search for talent, sourcing and markets.

There is much more to traditionally great leadership than this, of course. But the bigger question is: what's new in leadership? At least three imperatives stand out. First, business executives will need to go back to basics. The 1990s were about building new business models, but the years ahead will - or should - be devoted once again to building great institutions. The motto should be "Build to last", not "Build to sell".

Employees must be treated as long-term assets rather than commodities to be bought and sold. Executives will have to be paid for measurable performance and their salaries must be more in proportion with the rest of society. Their remuneration should be at risk if they do not create real value.

New technologies - how they are selected and embedded in the corporate culture - must be more judiciously managed; companies must move away from trying to be first with the newest toy. The inordinate focus on speed and scalability, typical of the so-called new economy, must be curtailed and replaced with a focus on quality and durability. I do not side with those who say that charismatic chief executives are a thing of the past; just that charisma is no substitute for substance.

Second, business leaders must embrace a stronger notion of their specific responsibilities. Take, for example, financial reporting. Global finance has become so complex that even the heads of financial institutions cannot always see the entire picture. Until this year, chief executives could rely on their finance directors and accountants to handle the details. In the US this is no longer possible, as regulators demand that chief executives take personal responsibility for their accounts. This pressure is mostly confined to the US but may well spread, especially to chief executives of companies wanting to list on a US exchange.

But finance is probably just the beginning. In a global economy, the bigger question is: when does a company become so big that a chief executive can no longer see - and by implication understand and take responsibility for - the entire operation? This question will arise with increasing frequency.

Third, business leaders will need to understand the role their companies should play in society. Their level of public engagement will have to rise considerably. In the past two decades, executives paid lip service to balancing the needs of shareholders and stakeholders. But let's face it: enriching shareholders, even in the short term, became the driving force for chief executives - the performance benchmark for both themselves and their companies. Of course, this was more the case with US companies, where even the word "stakeholder" is rare, but shareholder sovereignty drove others too - from Vivendi, to Deutsche Bank, to Sony.

The big societal questions for global chief executives will be extremely complex. They will take enormous amounts of their time and energy, and will require new kinds of partnerships with governments and nongovernmental organisations. For example, business leaders will certainly have to build stronger and deeper relations with employees, suppliers, customers and the communities they work in, or they will never regain the public trust that they have lost.

They will also need to make larger contributions to the big public issues of the day, such as protecting the environment and improving labour standards in poor countries, or face the risk of increased public protests followed by heavy-handed governmental regulation. All this at a time when shareholders are angry about the heavy losses of the past two years. They now expect not just more attention, more information and more of a voice in management - but a greater share in the profits.

Put another way, chief executives will be caught in the crosshairs of powerfully conflicting public pressures. It will take leaders skilled in more than just the generation of profits to cope.

Mission impossible?

Can global chief executives be great business leaders, visionaries, hands-on executives and statesmen too? I am cautiously optimistic. Top business executives, like leaders in any profession, are reflections of what their societies want from them. They come from those societies, exist to serve them and cannot stray too far from public expectations and still succeed.

For many countries, the past two decades were times of high growth and - to use a well-worn phrase - irrational exuberance. Private interests trumped all, and many corporations behaved accordingly.

Today and tomorrow, the combination of public cynicism about corporate behaviour and a sombre political scene is prompting a new focus on the public interest.

It is a time that has some parallels with the late 1940s, when a new world was being constructed out of the ashes of a global depression and a world war.

At that time, business leaders in America and Europe managed their companies while operating at the forefront of creating a new world. They recognised a new set of societal needs, and they rose to the occasion. Why not now?