Economist.com PEOPLE

Jeffrey Garten on business leadership

A new year; a new agenda

Jan 2nd 2003 | NEW HAVEN, CONNECTICUT
From The Economist print edition

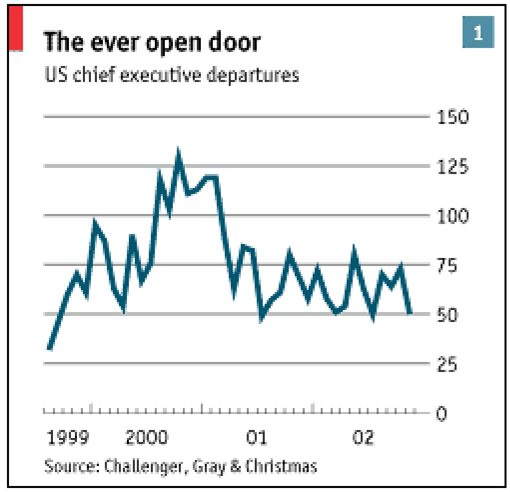
To succeed in the years ahead, business leaders need new strategies, both inside and outside their organisations

AT THE beginning of this century, business leaders were heroes and their future was bright. They could reasonably assume that the momentum for a more open world economy would continue, with more trade liberalisation, more deregulation, and more privatising of state-owned companies. But, in a short space of time, their world turned upside down. The economic expansion of the late 1990s came to an abrupt end; much more significantly, the terrorist attacks of September 11th 2001 ushered in a new era of geopolitical tension. At the same time, corporate scandals such as Enron and WorldCom revealed serious cracks in the foundations of corporate governance.

What now? What should corporate leaders be striving to attain in 2003? First, they need to grasp the political, social and economic context of their current predicament. Many of them underestimate the challenges they face, attributing their woes to a combination of cyclical economic factors and the over-reaction of regulators. As for corporate transgressions, too many subscribe to the few-rotten-apples-in-a-barrel theory, maintaining that the intense focus on patching up gaps in corporate governance is a political *jihad* that will lose its power.

When it comes to terrorism, they are of course anxious to improve security for their firms and their employees, but they do not think enough about the systemic implications of societies' rapidly escalating preoccupation with national security. In the same vein, they find it highly improbable that the kind of globalisation that they have enjoyed for decades could slow to a crawl or even come to an end.

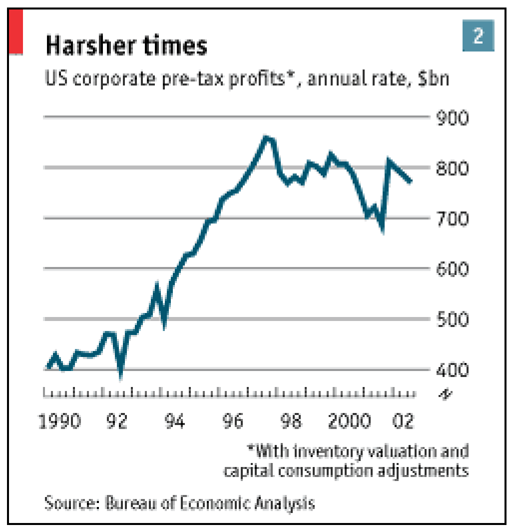
The truth is, however, that for many years to come, the operating environment for chief executives will be fundamentally different from anything they have known since the early 1980s. Regulators, while they have never disappeared, are back with a bigger and often more politically inspired agenda; national borders, which were beginning to wither, are once again in fashion; and the primacy of geopolitics over economics, which seemed to be diminishing, is once again a fact of life.



Facing the facts

With national security a top priority, governments are sure to increase financial regulation in their attempt to monitor flows of money that could finance terrorist activity. At the same time, they will want to slow down the movement of people across borders, and they will impose inspection regimes on trade flows that will inevitably raise the costs of global logistics systems. Just as important, the attention that top officials will be able to give to facilitating a more open global economy is bound to diminish while the war on terrorism is in its military stages.

Yes, there will be the obligatory push for another round of global trade negotiations, for new rules on banking regulation, and for policies to integrate emerging markets into the global system. But the passion that characterised such objectives among presidents and prime ministers in the 1990s lost much steam after the recent terrorist attacks. And it would be a mistake to think that this distraction is temporary. Today we are on the precipice of war with Iraq. But even if the battle is short, or even if it never takes place, the underlying terrorist threats won't go away for years, if ever.



The crisis in corporate governance also constitutes a marked shift in the environment for global investment. During the late 1990s, much of the world was moving towards an “equity culture”—a culture where people invest in markets rather than relying on government support. During the 1990s in America, for example, the number of people owning shares grew from about 40m to 85m. Around the world stockmarkets blossomed, and companies raised money by issuing shares and bonds instead of taking on bank loans. Indeed, the existence of such markets greatly facilitated sweeping changes in societies as diverse as Argentina, Brazil, China and India.

At the base of this revolution was the belief that markets were reasonably fair. This belief was sorely tested in the world's most sophisticated and trusted market—the United States—when so many highly touted dotcoms proved worthless, and as it emerged that the systems of accounting and auditing, not to mention the vigilance of regulators and boards of directors, were not what they had been cracked up to be.

There are some who believe that the high-water mark of concern about corporate governance was last year. Such scepticism is misplaced. In America, the pressures for the Securities and Exchange Commission and institutional investors to focus more intensely on overseeing corporations are likely to increase. Moreover, the efforts to achieve higher standards of corporate governance will be critical if countries from China to Germany are to have access to the capital that they will need in future.

On the inside...

The changed geopolitical situation and the collapse of faith in financial markets will test business leaders, who will need to possess a blend of old and new techniques. Above all, they will need a heightened sense of their roles in society.

Of course, many of the leadership skills that they already possess will continue to be necessary: there will be no substitute for being able to hire and retain top talent, nor for being able to engender the trust of colleagues and subordinates. And there will be no alternative to having a vision and being able to execute it effectively. Leaders will still need to understand how to integrate new technologies into their corporate culture, and they will still need to develop and implement effective global strategies. But there are a number of specific requirements that come with the new post-9/11, post-Enron era.

The times call for more attention to building great institutions

First of all, there will be a premium on focusing anew on fundamentals. Not long ago the fad was to develop new business models. Now the times call for more attention to building great institutions. There is a big difference. In the late 1990s, too many top executives were obsessed with moving at a breakneck pace even when they had incomplete information. Creating lasting value, however, puts less emphasis on speed and untested theories, and more on people, systems and solid investments.

Another aspect of building institutions concerns the role of the corporation in society. Is its goal primarily and exclusively to enrich its shareholders now? Or is its purpose broader—to create value by also enriching employees, customers, suppliers and the communities in which it operates? The 1980s and 90s were about short-term performance, judged narrowly by quarterly targets. In the years ahead, society will be looking to companies to have a broader focus on all stakeholders.

A second imperative for business leaders will be to embrace the new ethos of corporate governance while at the same time maintaining the courage to take educated investment risks. If the new economy saw some reckless behaviour by the corporate elite, there could now be too much of the opposite, with everyone wanting to play it too safe. It will be a supreme challenge to business leaders to steer the middle course. If they don't, a downward cycle could ensue: too little investment; too little economic growth; too few profits; and a sliding stockmarket.

There are no great solutions to this problem. But, at a minimum, CEOs need to:

•Install or upgrade risk management throughout their enterprises. They need systems that not only analyse risk, but also alert senior management at an early stage. Such systems need to apply to financial risks, of course, but also to commercial risks (being overtaken by competitors, for example, or losing major customers), regulatory risks, physical security risks, geopolitical risks and reputational risks.

•To surround themselves not with just the usual sycophants, but with men and women who are willing to challenge every decision. In the selection of directors, a premium should be placed on a wide range of expertise and backgrounds, but above all on people who will seek to expose the downsides as well as the upsides of every major decision.

Another task for business leaders is to redefine the character of leadership. Much of the past decade was about the swaggering and self-promoting CEO, but it would be a misreading of current and future requirements if business leaders concluded that charisma is a bad thing. Indeed, it is a trait that is part and parcel of effective leadership at any time. Jeffrey Sonnenfeld, a colleague at the Yale School of Management, has written that it is just a matter of how you define it. If a chief executive has an inner strength and a constant set of values that everyone knows and can rely on; if his personality inspires because of a combination of modesty and extraordinary competence; and if he is frequently in the trenches with his troops—if these are the kinds of qualities that emerge, as opposed to a lust for self-aggrandisement, then charisma is for sure a prerequisite for steering a big organisation.

These qualities are especially important because business leaders are being called on to make and implement far more difficult decisions. In the 1990s, it became easy to expand revenues and profits by the relentless acquisition of new companies, or by touting the incorporation of new technologies. Now companies are operating in a hyper-competitive global market where there is overcapacity in most industries. In such an environment they are being called upon to achieve profitability by relentless cost-cutting.

This entails heavy outsourcing to lower-cost labour and (often) moving business abroad. Inevitably, it also means large lay-offs. Implementing these policies will be painful and controversial. But the pain must be shared. One of the biggest blots on CEOs' reputations is the fact that they were rewarded whether their companies did well or not. It is time to end this egregious pattern.

One of the biggest blots on CEOs' reputations is the fact that they were rewarded whether their companies did well or not. It is time to end this egregious pattern

Yet another challenge for chief executives is to define their optimal span of control. They didn't worry about this issue in the 1990s. Bigger was simply better then; scaling up was a strategy in itself. But in the new era, chief executives and directors will need to ask: when is a company too big to be managed effectively? When do the various political and social problems of operating in scores of national jurisdictions become too much for the people at the top to discharge their full legal and moral obligations? Some notion of limits has to apply in the new era.

Beyond the new requirements of running their companies, there is an even bigger challenge for business leaders: calibrating a new level of public engagement. This was not much of an issue for Americans in the 1990s: the job of CEOs then was to focus on share prices—and little else. There was less need for public policy, so the implicit argument often went, because one way or another—through personal investments or through the taxes generated on the profits from investing—the market was taking care of public needs.

...on the outside

That era has ended, too. Government is back in full force, attending to national security with the same intensity as it did during the cold war. And it is also tightening its market surveillance. Without constructive input from business leaders, this could lead to a society that is either over-regulated or regulated in a way that undermines rather than strengthens markets.

Business leaders will always lobby governments in the interests of their companies and industries. And they will probably always maintain ties with certain government leaders that are too cosy. There is no point railing about that; it's a permanent condition. What is called for now is something over and above all that—namely, the involvement of business leaders in helping to shape the rules and institutions that will govern global society in the next few decades.

The top item on their agenda takes the most courage. Two dozen or so of America's captains of finance and industry need to stand up and say two things:

•That henceforth they refuse to give any money for any political campaigns.

•That they refuse to give Wall Street analysts any guidance about quarterly earnings, because such short-term targets are meaningless and ultimately corruptive of sound long-term management. Last month, Coca-Cola led the way by doing just that.

There could well be a ground-swell of corporate support for both moves, and they could be the beginning of a movement to extinguish two of the more pernicious trends in American-style capitalism that have sullied corporate reputations.

A number of American chief executives should also stand up and say that from today they will take the lead in pushing for strong corporate governance. Government has done enough; it is now the job of the leaders of companies. To start, they could gear their own remuneration to long-term performance and putting their compensation at risk when targets are not met. Then there are other challenges, such as separating the roles of chief executive and chairman, and looking more carefully at ways to protect workers' pensions.

American foreign policy could also use some constructive input. The biggest contribution chief executives could make would be to press the administration to stay on a multilateral course, rather than to follow the strong unilateral instincts of some of its members. Business leaders could also be helpful on a number of more specific issues. High on the list is figuring out how to build stronger economic and commercial ties with Europe, at a time when America's preoccupation with the war on terrorism is driving a wedge between Washington and Brussels. Another imperative: broadening and deepening NAFTA, at a time when progress there has come to a halt.

Consider, too, the shaky state of globalisation. Given the growth of terrorism and the policies it will spawn, the escalating disillusionment about free-market policies in Latin America, and the presence of a powerful anti-globalisation movement, there is at least an equal chance of a rolling back of much of the progress that was made in the past two decades. Leaders of multinational companies are today the only natural champions of an increasingly open world economy. Their agenda needs to include vigorous pressure on governments to move ahead with trade negotiations, and a push towards better mechanisms to ensure global financial stability.

There are many people within business and outside who believe that CEOs ought to focus on their firms and their shareholders and leave public policy to government. They say that when business leaders are publicly engaged, crony capitalism is the result. They could support my recommendations if all that were being advocated were more savvy public relations—but not if the recommendations mean substantive changes in what leaders actually do.

Yet business leaders in the past have been too short-term in their orientation, with great damage to shareholder culture. They need to think longer term. Yes, they should focus on shareholders; that's not in question. But how they do that, how they create long-term sustainable value, is the issue. And to do that, they have to take more account of their employees, their customers, their suppliers, and the health of their communities—and yes, the global economy, too.

In a perfect world, perhaps government could be relied on to build the social infrastructure in which business operates. In reality, in most countries the public sector is under-funded, under-staffed, and bleeding talent. It does not have the expertise to keep up with the rhythms of sophisticated global financial markets. International institutions are not in much better shape. The great issues of the day—from enhanced threats to national security to the need for a fairer framework for globalisation—all require new approaches that governments alone cannot handle.

The judicious involvement and help of experienced business leaders is essential.

The new challenge for global chief executives is both internal and external. It is legitimate to ask how many of them are up to this complex task. Can they run companies effectively and also play the broader public role that is required, or is this asking too much? Do they have the time, the skills and the desire to execute new kinds of inward and outward strategies?

An optimistic answer is conceivable for one simple reason: in the end, business leaders, like their political and military counterparts, are reflections of the societies from which they arise. In the 1980s and 1990s, society was generally comfortable with what business leaders were doing. Business conditions were good, jobs were being created, and people were becoming better off. Today, however, in an era when national security concerns are paramount, and when confidence in the fairness of markets is at a low ebb, a new breed of leader is called for. Let's hope that it starts to emerge in 2003.

Jeffrey Garten is dean of the Yale School of Management and author of "The Politics of Fortune: A New Agenda for Business Leaders" (Harvard Business Press, November, 2002). He was under-secretary of commerce for international trade in the first Clinton administration.