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INTERVIEW WITH SIR DAVID WALKER

Sir David Walker
Chairman of Winton Capital

Sir David Walker is a global leader in corporate governance. Currently Chairman of Winton Capital, he has been Chairman of Barclays, Chairman of Morgan Stanley international and an executive Director of the Bank of England. In 2009, he undertook a review of corporate governance for the British Government as part of its response to the global financial crisis. This led him to place greater emphasis on the question of corporate culture. He talks to Peter Montagnon.

What did you learn most from your review into banks?

If you go back ten years, if you talked about behaviour in companies, I thought that was all psychological soft stuff. I just wanted to focus on the business. When I did the governance exercise on banks, it was a tremendous learning process. What I learned most in doing my bank governance review – and a lot of this is the same for other major corporates – was about the importance of behavioural patterns. It's the job of the chairman to provide space for, time for challenge and to expect challenge in the boardroom and to get rid of non-executives who are not capable of it. The behavioural stuff is absolutely critical.

So this is different from compliance with rules.

It's the hard-soft paradox. If you are a financial institution - or if you're a pharmaceutical company - you are obliged to conform to what they call black letter legislation or regulation. You are required to have cert 12 % capital, 5% leverage, so much liquidity; you are required to subject your new drug to trials. The same goes for energy companies or anybody else.

Those regulatory requirements are black letter. You can tick a box at a point in time and say "yes" we have got this ratio, we have done this test, this pre-clinical trial. So you tick a box. You have to put resource into it, or you may have to build up your capital and sell subsidiaries to do so. But you get there. These hard requirements, the black letter stuff, are easy. It's a soft task.

The soft expectations which are behavioural are hard to deliver. I find that paradox quite helpful because you can have a finance director ticking the boxes on capital and liquidity but the behavioural stuff is not tractable in that way at all. One of the early problems is measurement. How do you calibrate? How do you know what you yourself are doing?

Is the ability of people to speak up a good indicator?

I do think it's important to note the difference between whistle-blowing and speak-up. One is much more important than the other. One is more relevant as an indicator of the state of health of the company than the other. Speak up is more important. Whistle blowing is what you have to resort to when someone is apprehensive and isn't ready to speak up. Speak up is something that happens openly. That actually is really the thing to commend.

So you need an atmosphere where people aren't afraid to speak their mind, and the board has to stand behind that?

Absolutely. The board's responsibility to identify, recruit and mentor the chief executive is a sacred trust. If you get it wrong, you damage the company for several years. If you get it right it can be magical. If a chief executive is autocratic and controlling, you won't get the atmosphere in which there is openness. A chief executive who is successful probably should not be there for more than a finite period, say four to six years. The proposition is that openness and the ability to speak up becomes much more difficult, the more successful the chief executive is. However concerned he is to have an atmosphere of openness.

So that's very important part of getting the culture right.

Absolutely. I mean the ability to challenge, and I think there are three layers to this. It's very hard for people to challenge from below, if you've got a very successful boss, if he's created a track record of achievement, quarter after quarter. Secondly, it's very hard for his "peer group", I mean the executive committee, to challenge for the same reason, and ditto for the board. Why should the board worry, if they've got someone who's producing good profits each quarter? The most serious risk in a good CEO is they cease to challenge themselves and start to believe in their own capacity. There is a loss of self doubt.

On the other hand the key requirement in a chief executive is to have the confidence to make decisions.

By definition, a successful chief executive, for precisely those reasons, has got to have a thick hide, has got to be able to sleep at night. Now that sleeping at night means you don't worry about someone you're controlling or who daren't speak up. As time goes on you get more and more confident. The skin gets thicker and you become a liability.

So succession planning is vital to culture?

I'm very clear that the chairman's responsibility is to ensure that there is a choice and that we've got internal as well as external candidates.

Isn't this different in family-owned businesses such as you often find in the Gulf region?

The key thing even for a family business is that they have to think about succession planning.

Maybe chief executives in family business stay for longer, say about eight or ten or 12 years rather than five or six or seven years in other companies. But succession planning is still very important. The more successful the business, the less people think about succession planning. People say: things are going well, what are you worrying about that for?

Isn't this a problem also with institutional shareholders? They don't worry when the business is performing?

That's just myopia. They need to remember sustainability, but the board is responsible.

How does this fit into regulation and supervision?

The bottom line from the regulators is that they know how important this is and how little they can contribute to it. They're very enthusiastic that others like the Banking Standards Board (a UK organisation founded and paid for by the banks to promote high standards of behaviour in the sector) should do as much as possible.

Yet don't they need to find out about the culture and use that as a risk measurement?

I'd go a bit further and say they are privy to the cultures of all the banks they regulate. And they'll be aware of different methods of calibration, different frequencies of measurement, so they are channels for communicating best practice and should work closely with organisations like the Banking Standards Board, which I think they are now starting to do.

Can regulators or shareholders do much about culture from outside?

If you're the regulator, you might become unhappy about behaviours in a particular bank. Yet you're not sure. You have no evidence that this involves breaches of unambiguous black letter rules. So there's no criminality, no evidence of the rules being breached, but you just think that the culture is a bit "high, wide and handsome" and there are a lot of complaints. Then you are absolutely empowered to talk to the chairman or chief executive about it and draw it to the attention of the board.

It's like speak up. There should be a relationship between the bank and the regulator which permits speak up. The trouble in the past was that the regulator would be all over you and send in enforcement teams. What's needed is a relationship of trust. Just as you need to build a relationship of trust, of trustworthiness in the eyes of your customers, that needs to be a part of the mutual relationship between regulator and regulated. The regulator comes to consult you about what he's proposing to do and you feel you can openly talk to the regulator about problems without being locked up instantly. The regulators have a responsibility to be trusted.

Here we are talking about a no blame culture, aren't we?

The danger is in some respects we're going the other way. You and I might think that it's appropriate for senior executives in a bank to have specific accountability for what happens on their watch. It's very important that that doesn't lead to precisely the opposite – to concealment for fear of what could happen. It's very important to strike the right balance. This is far beyond financial performance.

So is culture the new challenge for governance, and has governance hitherto been too limited to board processes?

A great deal of work was done by Adrian Cadbury (founder of the UK Governance Code) on board processes. We made a lot of progress on corporate governance. Then you move from the hard stuff – process – to the soft behavioural stuff. This is now on every board's agenda. They may not be doing enough. They've all got the diagnosis. They've probably not got the prescription.

I think the problem is where the shareholders are. I'm a chairman and I want to get all this stuff right. But my shareholders aren't interested. All they want is for me to go on delivering improved EPS or TSR or better quarterly earnings. I think there is a need for more to be done in this space. Beefing up the sensitivities of stewardship to cover this sort of stuff as well as financial performance is the next priority. I don't believe and never have in the efficient markets theory. If you have a doubt about this, think about the 2008 shock. Crisis will happen again and, every time it happens, the public attitude to big business and market capitalism will take a further knock.

Unless asset owners – the long term shareholders like pension funds and sovereign wealth funds - recognise this point and the importance of putting the emphasis on what's sustainable rather than just on what's good this quarter, the problem will get worse, not better.

Do companies focus too much on short term earnings?

We made great progress with the repeal in the UK of the requirement for quarterly reporting. But not many companies have dropped it.

Isn't it a good signal that that's been repealed?

Yes but the government hasn't made enough of it. They should say they are doing this to support a reorientation towards long term horizons, and say they're getting out of companies' way, removing a perverse incentive.

What about takeovers and their impact on culture?

A poorly implemented takeover will be catastrophic. Culture is usually the most prominent of the issues. The successful takeover requires much more attention and diligence to cultural issues than it ever gets. There is a lot of research to be done on why takeovers didn't deliver shareholder value on a sustainable basis. The truth of the matter is that most of them didn't.

It seems from what you're saying that a recurring theme is trust.

You could have the best Harvard Business School recommended business structure, and it won't work if there isn't trust among the senior people. If you do have trust among the senior people, the organisation's structure doesn't matter all that much. Take a global financial organisation or a pharmaceutical company or an energy company. You could have a head office in London or New York and you could have a spectrum of whether you have a lot of autonomy in the region or hub and spoke from the centre. Which is right? My answer is neither. The challenge is to find somewhere in the spectrum and the criterion is the relationship of trust among the senior people.