SPECIAL REPORT

Technocracy or Politics?: Reputation, Transparency and Leadership

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UCLM UNIVERSIDAD DE CASTILLA-LA MANCHA

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1.INTRODUCTION

We are not in crisis. By definition, a crisis is an abrupt change in a process of doubt or an awkward situation. This is not the case here: there is no way back, we cannot put the pieces together again.

We are undergoing a structural change insofar as it is not possible to restore an economic system that has been shattered to pieces after witnessing the collapse of its institutions, for which it more or less rightly blames the financial industry, the banking sector and the insurance world. We need an innovative transformation, a sort of disruption in our way of understanding global capitalism.

And, seeing the ability of the present cohort of European politicians, the solution to these challenges is not to be found in the world of politics. In particular, this crisis has highlighted the knowledge, leadership, honesty and fairness displayed by the leaders of Iceland —some of them now in or on their way to prison—, the defeated governments of Ireland, Greece and Portugal —of the Fianna Fáil party, conservatives or socialists, respectively, prior to the intervention of their economies, Papandreou's socialist government in Greece or Berlusconi's populist government in Italy-after the interventions— or the lack of empathy and tremendous boredom of Spanish electors with their previous socialist government and the problems anticipated for the incumbents of France and Germany in their decisive 2012 and 2013 respective elections.

Furthermore, the calls for a return of national regulation will not solve the problems, since it is not possible to legislate a transformation that is taking place in real time across the entire planet. Even if the political leaders wanted to, they could not solve the crisis just by passing decrees.

The debate has moved over to the economy and the above-mentioned challenges are now on the desks of executives of large corporations and financial institutions in the developed world.

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The *leit motif* of this change is the exhaustive review of management models and assessment of the results of financial organisations and companies.

It should not take us by surprise, then, that this issue hits the headlines time and again in the international benchmark financial press and is a recurring topic in the most prestigious business schools. It is down to the heads of economic organisations to lead the change, generate new management standards and support the development of corporate citizenship.

In particular, the Financial Times has published numerous op-eds and editorials suggesting that capitalism can only survive through change and it has launched a bold, intelligent and well-argued series of articles, —true to the style of that exemplary newspaper, which all the others should try to imitate and which all readers in the business world and, if only!, in politics should use as daily intellectual gymnastics—, which has been publishing for some months now, under titles such as "*The Squeezed Middle*", in reference to the situation of the United States of America, or "*Capitalism in Crisis*", in reference to the global framework of "The Great Recession".

And the newspaper's conclusion is clear, as all these contributions point to three main areas requiring attention in order to get out of the maize we are in: better regulation of the financial industry, extension and implementation of effective corporate governance systems and tax and monetary policies focusing on solving the present problem, which stems from the doubts regarding the solvency of sovereign debt in the EU countries and the weak demand in the countries in recession.

In short, if we had to sum up the vision of the current problem using concepts more commonly found in executive management, not only in the world of politics but also in the corporate and financial world, they would be related with the absence of Leadership, Transparency and Reputation.

In March2011, Harvard Business Review (HBR) joined in this debate with an article entitled "*Capitalism for the Long Term*", written by Dominic Barton, Global Managing Director of McKinsey, which is probably, along with Bain, one of the two most prestigious consultancy firms in the world.

Barton considers the voracity of institutional investors incompatible with sustaining a business because the results of a company cannot be assessed every quarter as though it were the Final Judgment.

In a globalised, interconnected world in constant turmoil, the performance assessment process is much more complex than just observing the results of the last quarter and comparing them with those of the previous quarter, with the same quarter of last year or, in a tremendous exercise of maximum executive intellectual sophistication, comparing them with the continuous evolution of the last four quarters.

In Dominic Barton's opinion, Q1-Q4 capitalism does not allow businesses to develop. According to Barton, a new business line usually needs five to seven years to become profitable.

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Clayton Christensen, Professor at Harvard Business School, proved some time ago that the obsession for profit wiped out innovation in many industries. If they concentrate exclusively on operating management —ratios, growth percentages or quarterly results—, they may end up forgetting their Vision, Mission and Values, and even their business project.

Roger Martin, Dean of the Rotman School of Management in Toronto and one of the 50 most influential thinkers in the business world, has written that as a result of steering management towards maximising the share value, executive remuneration has rocketed —especially their variable pay— causing a rift between wealth and value creation.

Martin writes that in recent years management of prospects (the management of shares and other derivative financial products) has taken precedence over the real business, that is, the business that creates value through the design, production or sale of products and services to meet real or expected needs of the market and consumers.

The fiction of financial engineering led to the failure of strategies based on social responsibility as the only tool of the marketing plan, in an exercise of "*green washing*" or "*social washing*", i.e., giving organisations an environmental or social facelift while they had no real commitment to redirect business towards creating shared value with their critical stakeholders.

Fortunately, some European banks are now beginning to rethink their business model and how they earn money —as suggested by Jorge Cachinero and Axel Gietz in their recent essay "*Held to Account with Nothing to Bank On Anymore. The Reputational Free fall of the Financial Services Industry: Why It Is Unprecedented and How It Might Be Reversed*" published by **d+i LLORENTE & CUENCA**— and they are questioning andeven closing business units associated with high-risk activities and starting to go back to the old model of banking as a financial backer of sustainable long-term industrial, business, commercial and family projects.

In this context, it would seem appropriate to think we need:

- **New management tools to reorganise priorities.**
- **To redesign the business model, focusing it on the long term and how money is legitimately earned with it.**
- **To generate, pick up and disseminate new ideas.**
- **To retain talent.**
- **To protect natural resources.**
- **Commitment to the society we operate in.**

“It is illogical to reward growth in the share’s short-term value achieved at the cost of destroying its long-term value”

This goes beyond communication and into the terrain of Strategy definition.

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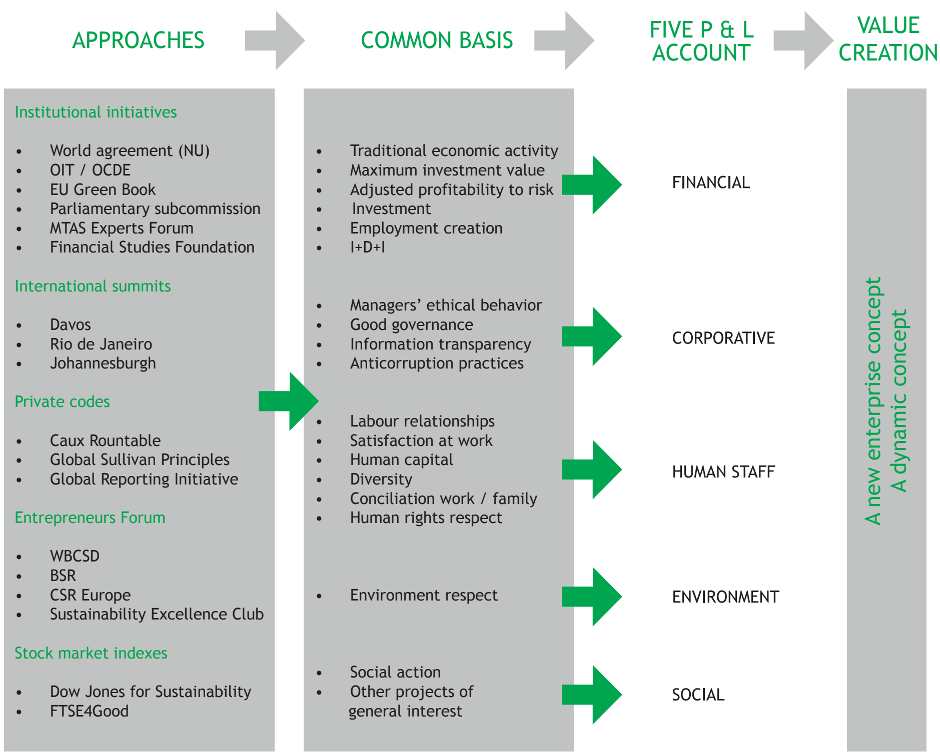
It is working for a set of Five P&L Account (Economic-Financial, Sustainability and Environment, Ethics and Governance, Talent and People and Contribution to Society) and not just for the Economic-Financial P&L, however important it is, and it is important.

Five Profit & Loss (P & L) Account



Source: Entreprise and Society Foundation

2. TOWARDS REPUTATIONAL CAPITALISM IN A REPUTATION ECONOMY

Business administration manuals remind us that what cannot be measured cannot be improved, so is not managed. Because in practice, the measurement of results reflects the real interests of companies, in that they are rewarded or punished for the consequences of the decisions they have made.

For this reason, it is illogical to reward growth in the share’s short term value achieved at the cost of destroying its long-term value. The latter is supported by good management of processes and business operations, but above all it is underpinned by management of Credibility, Reputation and Brand, i.e., the intangible assets of the business, which are always, especially in the wake of the devastating effect of *“The Great Recession”*, the most valuable assets of any organisation.

None of the senior management of companies or financial organisations such as Goldman Sachs, Toyota or British Petroleum would dispute this. It would be difficult, although very interesting, to track down the senior executives of Enron or Arthur Andersen to ask them what they think.

In these difficult times of the present “*Great Recession*”, numerous public opinion surveys confirm the declining credibility of institutions, companies, the government and even non-profit organisations.

“Reputational Capitalism offers two tools for levering change and favouring a new business management model: sustainability and transparency”

There is no trust in their future behaviour. Of all these, trust in the media is crumbling fastest.

Trust is transformed into social capital, which is defined by Francis Fukayama as the ability of people to work together for common purposes in groups and organization. Social capital derives from our ability to establish social relations, trust others or establish common rules of honesty and reciprocity. It is the third form of capital, after physical capital and human capital. Each culture establishes an initial setting for social capital according to the role of families, the State or organisations.

As societies are able to generate institutions of trust, corruption and inefficiencies of the system are reduced.

According to Coase’s hypothesis on signatures, trust lowers transaction costs through the recognition of a small number of agents operating on the market.

In this regard, there is a consensus on the value of Reputation, in that there is a direct relationship between tangible assets —the economic results— and intangible assets —trust—. For example, yield can be measured and managed as the return conferred by a customer on the positioning of a brand.

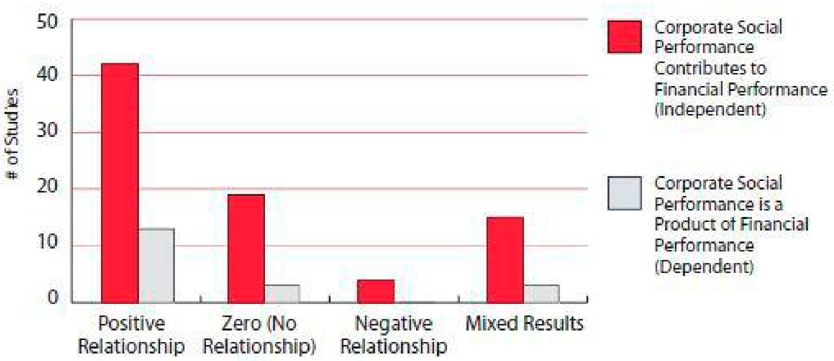
According to the data published by the Reputation Institute, there is a strong relationship between Reputation and customer support: earnings can improve by 5% and recommendations by 7.3%. In terms of consumption, they are important figures.

In short, trust is not only the invisible fabric that keeps together the open, democratic societies in which we have the privilege of living; it is also the most valuable relation capital that the critical stakeholders of a business give business and financial organisations in return for their transparent, socially acceptable behaviour. That is the value of Credibility and the source of Reputation.

And progress towards achieving this and its value are measurable, just like any other asset of an organisation, with management solutions already on the market, requiring only sufficient leadership to make them the heart of its business model.

Organisations that manage their assets in this way can be distinguished. Reputational Capitalism offers two tools for levering chan-

Exhibit 1. Summary Results of 95 Research Studies



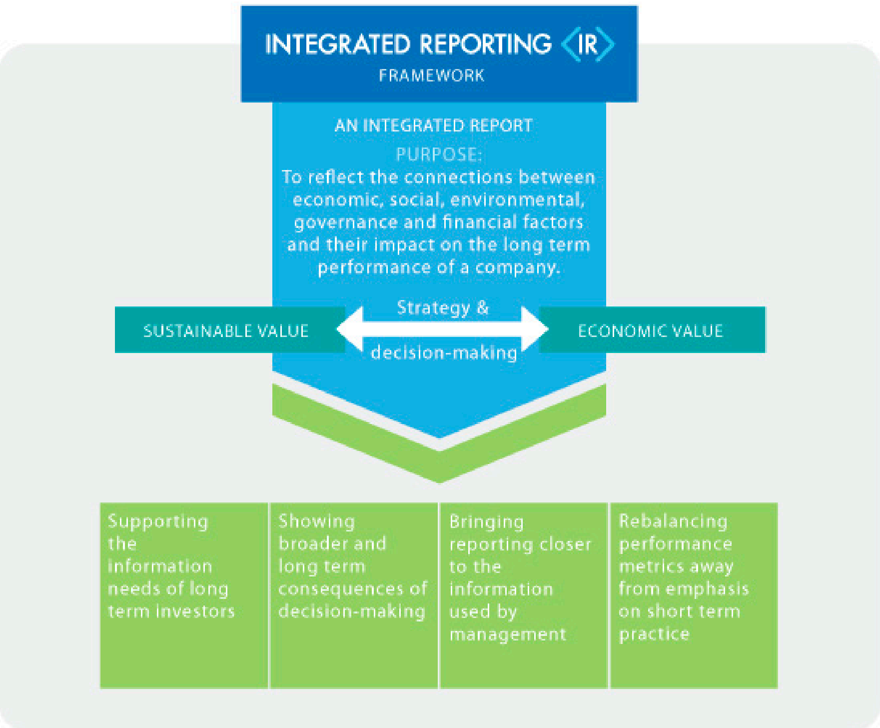
Source: Margolis, Joshua D., and James P. Walsh. People and Profits? The Search for a Link between a Company´s Social and Financial Performance. Mahwah, N.J.: Lawrence Erlbaum Associates,2001.

"Improvement of governance, demonstration of commitment to society and standardisation of management reports in the medium term are specific ideas for good corporate governance and for supporting the Reputation economy"

ge and favouring a new business management model. The first is Sustainability, i.e., the creation of a selfsuppoting economic relationship that generates long-term wealth. The second is commitment to Transparency as a process that reveals the interest of the company in securing yield for its stakeholders and society. There will be occasions in the future to discuss this second tool in depth.

3.SUSTAINABILITY AND BUSINESS

For years, we have seen how companies have used this magic word, Sustainability, as just another element in social marketing. Green products or environmentally responsible attitudes were patent in responsibility reports.



But that narrow-minded vision of Sustainability is destined to disappear. That is not the way to promote companies: sustainability establishes a lasting, stable relationship with the environment. It consists of creating new business models that are inclusive, that generate value for all stakeholders and that produce long-term profits.

Michael Porter and Mark Kramer have written about this new trend in Harvard Business Review ("*Creating Shared Value*"). The authors believe that the solution to the crisis lies in creating new business opportunities by redefining productivity and the business value chain. It is illogical for companies to suffocate the environment in which they operate; it is necessary to find healthier products, use cleaner energies and reduce adverse external factors. Sustainability is the generation of long-term value and growth in new business areas to the detriment of others.

There is no universal formula, although there are alternatives striving to make progress. Among many others, we could mention the international *slow movement*, which advocates slowing down the pace of life. Founded in 1986, we can find *slow food* (eating better and following a Mediterranean diet), *slow cities* (intensive use of renewable energies, environmental architecture) or *slow money* (micro investors who support the ecological agricultural industry), among other versions. On the other hand, there is already talk of proximity capitalism, which in-

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volves products, distributors and consumers in the value chain to further local development. Distribution firms have taken advantage of this demand to create new products and markets linked to sustainable values. The success of these alternatives has yet to be seen, but they reflect a social concern that companies will eventually respond to in their *Unique Selling Propositions* (USPs).

In any case, within this context and more immediately, moving fast and aiming directly at the heart of the decision-making process of companies and financial institutions, Reputation and its management have become the centre of gravity of all those who aspire to achieving recognition by the critical stakeholders of those businesses, so that their long-term shared value proposals are accepted as credible and transparent and, as such, deserve to be backed, approved, prescribed or consumed.

Improvement of governance, demonstration of commitment to society and standardisation of management reports in the medium term are specific ideas for good corporate governance and for supporting the Reputation economy. The organisations that first lead this strategic change will be able to reposition themselves, reduce trade-offs in decisionmaking and steer towards the most beneficial objectives for stakeholders. Companies that integrate the values in their business project and assign resources to them will have a competitive edge: Reputation cannot be copied and does not leave with the executives.

It is a decision that will affect the performance and management of operations, so Reputation is, in itself, a growth strategy.

We will pull out of the crisis. We are sure of that. But we are equally convinced that we need a growth alternative and a different strategic approach. And, once again, obtaining that much-desired Reputation, like a corporate Holy Grail, must be one of the priorities of the Senior Management of any business organisation or financial institution —and of its Board of Directors or Executive Committee to direct its implementation within the organisations— and human and financial resources must be assigned to achieving it, in proportion to the challenge taken on, and progress towards its achievement must be measured precisely, based on expressions and reality and without any concessions to complacency or vanity.

AUTHORS

d+i LLORENTE & CUENCA

Jorge Cachinero is Senior Director of Reputation & Stakeholder Loyalty and Innovation and Corporate Development in LLORENTE & CUENCA and Professor at the IE Business School in Madrid, where he obtained his Executive MBA. From 1999 until he joined the Firm in early 2011, Jorge was Japan Tobacco International's Director of Corporate Affairs and Communication for the Iberian Peninsula (Spain, Portugal, Andorra and Gibraltar). Before that, he was Ford Motor Co.'s Director of Government Relations and Public Affairs and Secretary of the Board of Directors for Spain and Portugal.

UCLM
UNIVERSIDAD DE CASTILLA-LA MANCHA

Juan Luis Manfredi is a Professor in Journalism at the University of Castilla-La Mancha and contributor to the economic newspaper Cinco Días. He is Chief Researcher of the Mediadem Project in Spain, which, funded by the European Commission, examines communication policies and democracy in 14 European countries.

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Organisation

CORPORATE MANAGEMENT

José Antonio Llorente
Founding partner and President
jallorente@llorenteycuenca.com

Enrique González
Partner and CFO
egonzalez@llorenteycuenca.com

Jorge Cachinero
Corporate Director of Innovation
jcachinero@llorenteycuenca.com

IBERIA

Arturo Pinedo
Partner and General Director
apinedo@llorenteycuenca.com

Adolfo Corujo
Partner and General Director
acorujo@llorenteycuenca.com

Madrid

Joan Navarro
Partner and Vice-President of Public Affairs
jnavarro@llorenteycuenca.com

Amalio Moratalla
Partner and Senior Director
amoratalla@llorenteycuenca.com

Juan Castillero
Financial Director
jcastillero@llorenteycuenca.com

Lagasca, 88 – planta 3
28001 Madrid
Tel: +34 91 563 77 22

Barcelona

María Cura
Partner and General Director
mcura@llorenteycuenca.com

Muntaner, 240-242, 1º-1ª
08021 Barcelona
Tel: +34 93 217 22 17

Lisbon

Madalena Martins
Founding Partner
mmartins@llorenteycuenca.com

Carlos Matos
Founding Partner
cmatos@llotenteycuenca.com

Rua do Fetal, 18
2714-504 S. Pedro de Sintra
Tel: + 351 21 923 97 00

LATIN AMERICA

Alejandro Romerozz
Partner and Latin American CEO
aromero@llorenteycuenca.com

José Luis Di Girolamo
Partner and Latin American CFO
jldgirolamo@llorenteycuenca.com

Antonio Lois
Regional Director of Human Resources
alois@llorenteycuenca.com

Bogota

María Esteve
General Director
mesteve@llorenteycuenca.com

Germán Jaramillo
President Director
gjaramillo@llorenteycuenca.com

Carrera 14, # 94-44. Torre B – of. 501
Bogota (Colombia)
Tel: +57 1 7438000

Buenos Aires

Pablo Abiad
Partner and General Director
pabiad@llorenteycuenca.com

Enrique Morad
President Director for the Southern Cone
emorad@llorenteycuenca.com

Av. Corrientes 222, piso 8. C1043AAP
Ciudad de Buenos Aires (Argentina)
Tel: +54 11 5556 0700

Lima

Luisa García
Partner and CEO of the Andean Region
lgarcia@llorenteycuenca.com

Cayetana Aljovín
General Manager
caljovin@llorenteycuenca.com

Av. Andrés Reyes 420, piso 7
San Isidro. Lima (Peru)
Tel: +51 1 2229491

Mexico

Alejandro Romero
Partner and Latin American CEO
aromero@llorenteycuenca.com

Juan Rivera
Partner and General Director
jrivera@llorenteycuenca.com

Bosque de Radiatas # 22 – PH7
05120 Bosques las Lomas (México D.F.)
Tel: +52 55 52571084

Panama

Javier Rosado
Partner and General Director
jrosado@llorenteycuenca.com

Avda. Samuel Lewis. Edificio Omega, piso 6
Tel: +507 206 5200

Quito

Catherine Buelvas
General Director
cbuelvas@llorenteycuenca.com

Av. 12 de Octubre 1830 y Cordero.
Edificio World Trade Center, Torre B, piso 11
Distrito Metropolitano de Quito (Ecuador)
Tel: +593 2 2565820

Rio de Janeiro

Juan Carlos Gozzer
General Director
jcgozzer@llorenteycuenca.com

Rua da Assembleia, 10 – sala 1801
Rio de Janeiro – RJ (Brazil)
Tel: +55 21 3797 6400

São Paulo

José Antonio Llorente
Founding partner and President

Alameda Santos, 200 – Sala 210
Cerqueira Cesar. SP 01418-000
São Paulo (Brazil)
Tel.: +55 11 3587 1230

Santiago de Chile

Claudio Ramírez
Partner and General Manager
cramirez@llorenteycuenca.com

Avenida Vitacura 2939 Piso 10. Las Condes
Santiago de Chile (Chile)
Telephone: +56 2 24315441

Santo Domingo

Alejandra Pellerano
General Director
apellerano@llorenteycuenca.com

Avda. Abraham Lincoln
Torre Ejecutiva Sonora, planta 7
Tel: +1 8096161975

Corporative webpage
www.llorenteycuenca.com

Corporative blog
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