SPECIAL REPORT

HELD TO ACCOUNT, WITH NOTHING TO BANK ON ANYMORE

The Reputational Freefall of the Financial Services Industry: Why It Is Unprecedented and How It Might Be Reversed

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1. A BRAVE NEW WORLD FOR BANKS

The latest G20 meeting in Cannes was hosted by the French government under the motto, "New World, New Ideas".

One of these new ideas designed to meet the challenges of the future was to draw up and announce a list of the world's biggest 29 banks (by balance sheet) which were deemed to be "Relevant to the System". The governments of the 20 leading national economies have agreed these are to be restructured and regulated in a way to prevent the taxpayer ever again having to cover their losses - easier said than done of course[1].

The 29 banks stand for an industry that has collectively managed to destroy its reputation over the past years. Net result - it has become the corporate Public Enemy Number One.

If ever the famous, if somewhat crass, old adage, 'Credibility is like virginity – you only lose it once', was applicable, it seems to be the case here.

Looking at past instances of companies that fell from grace, we will argue why this time it's different – worse actually. And we will tackle the all-important question what banks can do to restore trust and rebuild their reputations.

[1] In alphabetical order, the U.S. banks are Bank of America, Bank of New York Mellon, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, State Street, and Wells Fargo. The European institutions are Banco Santander, Banque Populaire, Barclays, BNP Paribas, Commerzbank, Crédit Agricole, Crédit Suisse, Deutsche Bank, Dexia, HSBC, ING, Lloyds Bank, Nordea, Royal Bank of Scotland, Société Générale, UBS, and UniCredit. The banks from Asia are the Bank of China, Mitsubishi UFJ, Mizuho Financial Group, and Sumitomo Mitsui Banking Corporation.

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2. FLAWED ICONS: WHERE THINGS HAVE GONE WRONG IN THE PAST

The first association that comes to mind of a whole industry under long-term siege is "Big Tobacco". However, except for their most unforgiving critics, most people will agree that at least for the past decade or so, the nature of the product they make and sell rather than the way they conduct their business has been the bone of contention. And even when their reputation was at its lowest point, smokers never took to the streets in protest, occupied tobacco fields, or camped outside their corporate headquarters buildings. Crucially, shareholders have always been happy with them, which applies equally to a number of other industries some have grouped collectively as "sinful stocks"[2].

Then there is another category, historic text-book examples of disgraced companies whose products *per se* were not considered "sinful", but who still managed to maneuver themselves into very uncomfortable situations.

Who does not remember the cases of Shell (following the Brent Spar platform disaster); Exxon (following the Exxon Valdez Alaskan oil spill); Coca-Cola (following sales of contaminated product in Belgium); or indeed, Enron and WorldCom.

The first examples include companies where things went wrong and – importantly – the crisis communications following the incident were terrible. The public, whose perceptions are defined by the media, will understand that even in the best-run companies bad things can happen, but they are less tolerant if the response to such an incident comes across as flippant, incompetent, and dismissive of legitimate concerns.

And yet, even under such difficult circumstances people are much more likely to remain supportive, while vigilant, if they have come to know the corporation in "normal" times as accessible, transparent, and, ultimately, trustworthy. It's called putting money in the Favor Bank and helps to explain why these companies have managed not only to survive, but carefully to rebuild their reputations and boost their share price – over time.

Without wanting to give away the punch line – unfortunately, banks have traditionally not paid too much attention to building that kind of relationship with their critical stakeholders. It could be said they never really understood why theirs was called the financial *services* industry.

The last two names are those of companies where wrongdoing was, or was at least found to be, endemic rather than just confined to isolated, if serious, incidents. Enron and WorldCom simply no longer exist, serving as the ultimate warning signs for careless corporate leaders.

[2] The website Investopedia defines "sinful stocks" as follows: "Stocks from companies that are associated with (or directly involved in) activities that are widely considered to be unethical or immoral. Examples of activities some people may consider sinful include the distribution or production of alcohol, tobacco, weapons and sex-related products." (www.investopedia.com/terms/s/sinfulstock.asp#axzz1d2SrGS00). Also "vice" stocks.

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A particularly interesting case in point is BP. Until 2010, it could serve as a prime example of a company whose standing, built over the years under the promise "*Beyond* Petroleum", was strong enough to weather a number of storms: material safety deficiencies in their Texan operations, leading to 15 dead workers following an explosion in 2005; a serious oil spill in Prudhoe Bay, Alaska, in 2006; and the rather sudden departure of their long-time Chairman, a hero of British industry, under very ignominious circumstances in 2007. Their share price quickly recovered after each of these blows.

But then the Deepwater Horizon oil spill in the Gulf of Mexico happened, and both the magnitude of the disaster – caused by an irresponsible combination of negligence, lack of control and coordination, and cutting of corners - and, crucially, the abysmal way the company handled itself and communicated with stakeholders after the incident, led to a dramatic loss in Reputation and, with it, a cataclysmic fall of the share price. According to Professor Daniel Diermeier from the Kellogg School of Management at Northwestern University, the total cost for BP in market capitalization terms ranged in the vicinity of $90Bn[3] - that is to say, the equivalent of Procter & Gamble's value as a company. Truly staggering!

In this situation, the general perception created, rightly or not, was one of a corporation that had simply lost its plot and where acceptance of responsibility was to be avoided, quite literally, at all costs. Especially in the U.S., the "victim country", in a general outburst of hostility with xenophobic undercurrents the condemnation of *British* Petroleum was universal, with none less than the President leading the charge. To this day, the company has not recovered, and no-one can predict how long it will take to do so. All the while, of course, the world still needs exploration, production, and supply of fossil, energy and BP continues having a huge role to play in this context.

But if you think that was as bad as it gets, think again. This time, it's more dramatic still, and not just because the financial services industry has at least 20 governments breathing down its neck.

3. THE PERFECT STORM: BANKS IN A BIND - AND CONSUMERS IN CONTROL

In the case of the banks, the general perception across all nations and societies is one of a disgraced industry that has lost its way and its moral bearings, that is defined by greed, that doesn't understand its own products anymore, that is totally out of control as politicians and regulators understand them even less, and that, ultimately, has lost its license to operate.

And as if the world needed a reminder, MF Global has graciously supplied it.

The U.S. "Occupy Wall Street" movement and its counterparts in many other (developed) countries,

[3] Diermeier (2010): "Crisis and Reputation Management" (.ppt).

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like the "Indignados" in Spain, sets a precedent – never before have consumers, who are at the same time tax payers and voters, staged militant protest events of this magnitude and geographic spread around the world against one single industry whose products they all rely on in their everyday lives. This also puts more pressure than ever before on politicians to do something - if they only knew what…

The dilemma is exacerbated by the fact that banking cannot just be banned or abolished. If push came to shove, the majority of the population could probably live without guns, alcohol, and cigarettes (Fast Food, anyone?), although history has shown prohibition does not work. What's more, in a number of highly industrialized countries, nuclear energy is being faded out as we speak.

But going back to bartering is just not an option.

In this situation, it seems militant consumerism, the market-economy expression of democracy, has finally found its true vocation. This was shown beyond doubt by the process that has forced giant Bank of America, number 7 on the G20 list, to withdraw its widely announced plan to charge U.S. customers a monthly fee of $5 for their debit cards. All thanks to the power of one angry person, muddling through to make ends meet, her determination, the new technologies of information and communication (aka TICs), and an old pair of scissors with which she cut her debit card in two.

Interestingly enough, BofA only came up with this idea in order to compensate losses resulting from new federal regulation which significantly reduced the hidden "swipe fees" banks had quietly collected before whenever customers used their debit cards. Once transparency had been established, consumers simply refused to pay additionally for the right to spend their own money.

In a thoughtful analysis of this case, *USA Today*[4] called this "the Occupy Wall Street of the no-longer-silent majority", putting it into the broader context of "consumer rage in an electronic age" dominated by the new social media: "Most corporations become aware of the wallop of this emerging consumer power only when they make a serious mistake and fall victim to it. This new, power-to-the-grumbler movement is only going to grow."

According to an expert quoted in the piece, two other factors contribute to this new phenomenon still little understood by the corporate world: frustrated consumers, the growing percentage of people experiencing serious problems with companies, products, or services; and "A chance to matter. Many consumers are anxious about their jobs; angry about their salaries and increasing workloads; upset about climbing health care costs; and worried about their mortgages… [But] there's still one thing under their control: the chance to speak out."

In this heated, antagonistic atmosphere, those working in the financial services industry see themselves attacked and despised, both in the public debate and in their personal lives,

[4] *USA Today*, November 2, 2011.

in a way that only the infamous "MOD Squad", Christopher Buckley's cynical and provocative creation of the Nineties, were used to until now – executives from the tobacco, alcohol, and weapons industries.[5] See below responses from the *Industries I can trust* poll taken annually by Harris Interactive.

	2003	2006	2009
	%	%	%
Supermarkets	40	34	36
Hospitals	34	28	28
Computer Hardware Companies	27	20	23
Computer Software Copanies	22	23	20
Electric and gas utilities	n/a	14	16
Packaged food companies	23	14	16
Online retailers	n/a	11	16
Banks	35	31	12
Airlines	20	16	10
Life Insurance companies	11	11	10
Telephone / Telecommunication companies	12	10	10
Pharmaceutical and drug companies	13	7	9
Car manufacturers	14	9	8
Health insurance companies	7	7	7
Managed care companies such as HMOs	4	4	5
Oil companies	4	3	5
Tobacco companies	3	2	3
None of these	37	40	44

Note: multiple-reponse question n/a = industry not asked about that year

Source: Harris Interactive, Inc. (2009)[6]

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Given this remarkable decline in Reputation, it should not come as a surprise to anyone then that Hollywood has picked up on the sentiment of frustration and anger against the banking industry as it quite rightly sees a business opportunity to ride this wave with films like "Inside Job", "Margin Call", and "Tower Heist". We have come a long way from Gordon Gekko, the archetypal corporate raider, and his credo that "greed is good" ("Wall Street", 1987). But then, he is a dinosaur, a lost cause: freshly out of prison, 13 years on he still proves himself unreformed and immune to today's changed environment ("Wall Street: Money Never Sleeps", 2010).

And yet, everybody needs a bank (account), and the world needs banks – at least in their classic and traditional role as lenders to businesses and private individuals, and as facilitators of payments. Beyond these activities, however, many today already draw the line at investment banking.

To acknowledge this, in Germany the public discourse, in labeling those employed in the financial services industry, has begun to differentiate between "Bankiers" (the good guys engaged in the traditional, beneficial activities) and "Bankers" (the bad guys doing everything else that has led to the global financial crisis)[7].

It seems "bankers" have an almost unwinnable struggle on their hands to reverse these powerful trends. What can or should the industry do in order to be let back in from the cold, so to speak, and allowed a meaningful role to play in determining its own fate?

[5] MOD: Merchants of Death. Christopher Buckley, Thank You for Smoking (1994).

[6] *Industries that are generally honest and trustworthy* - The Harris Poll. Harris Interactive, December 1, 2009. Daniel Diermeier, Reputation Rules (2010).

[7] Differentiation first introduced by former Federal President Horst Koehler who has a banking background himself.

"In a nutshell their desired contribution could be defined as 'doing the utmost possible good for the greatest possible number of people'. And, crucially, they must manage to convey this new interpretation of their role not just to their traditional stakeholders, but to Society at large, in a manner that is credible, convincing, and consistent"

4. FACING THE MUSIC

Given the fact that a return to a pre-capitalist, bartering-based economic model is out of the question, and that the financial services industry will always have an important contribution to make to economic growth and thereby to human welfare globally, in a nutshell their desired role could be defined as "doing the utmost possible good for the greatest possible number of people". And, crucially, they must manage to convey this new interpretation of their part not just to their traditional stakeholders, but to Society at large, in a manner that is credible, convincing, and consistent.

First efforts at coming out of denial and facing the music as it were have been made. Recently, Bob Diamond, CEO of the British bank Barclays (number 6 on the G20 list), gave a speech at the BBC in London where he tried to address the current widespread concerns about his industry.

Unfortunately, even neutral to well-meaning commentators like *The Financial Times* dismissed his initiative as insufficient as his comments fell short of addressing what they consider to be the core of the dilemma: "The problem banks face is not that people believe all financial products to be socially useless; it is rather that they question the culture within banking institutions. The asymmetry of risks and rewards has led to very poor social outcomes. Bankers have benefited massively from loading individuals and institutions with unnecessary debt or churning investment portfolios to extract transaction fees…. Mr. Diamond is right to think that banks need to be better citizens. But this requires them first to acknowledge that a conflict may exist between their interest and that of the wider public." In conclusion, the FT editorial called for "lower banking profits and pay" as a "first step Mr. Diamond and his colleagues must take … to show they understand this."[8]

However, beyond accepting significant cuts in income, both as corporations and as individuals, which is hard enough to do already, leaders of the banks industry would be well advised to consider some crucial additional steps from a corporate reputation management perspective.

Importantly, these should be undertaken as an industry wherever possible. With their collective backs to the wall, banks will gain nothing by engaging in competitive jockeying for positions. Experience shows once media, politicians, regulators, and the general public has lost patience and trust, they prefer to deal with one party rather than a multitude of individual industry players.

5. RE-ENTERING THE REALM OF RESPECTABILITY

Based on the above, there seem to be at least six initiatives the banks should take in order to avoid becoming the **PARIAH** of the 21st Century:

[8] "Diamond's lecture", *The Financial Times*, November 5/6, 2011.

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Proactively engage in the public debate

Burying one's head in the sand like an ostrich is no longer a viable option for any industry which aspires to come out of the Great Recession with a robust long-term game plan in order to continue being relevant for the market and its consumers. The operating environment in which all business is nowadays conducted is characterized by an unprecedented level of transparency and visibility: every financial institution's corporate headquarters building has a crystal ceiling, walls, and floor.

Thanks to the new TICs (technologies of information and communication), each and every single individual's negative opinion about a financial organization can literally reach any corner of the world in seconds and represent an *imminent and present danger* for its Reputation.

These TICs are not only very powerful tools for disseminating information; they have also created the window through which corporations in all sectors are exposed to close, unforgiving societal scrutiny – 24/7 and on a global basis.

In the age of twittering I-Reporters carrying smartphones equipped with photo and video cameras, traditional mass media have become a perishable good – yesterday's news, so to speak - since what citizens and consumers everywhere are looking for is, yes, information, but, above all, conversations in which they can participate and contribute. To put this mass phenomenon into perspective: if Facebook were to join the United Nations as a separate entity, the number of people using it would make it the 8th largest member of that organization.

The motto of the venerable *New York Times*, printed under its masthead, is: "All the news that's fit to print." The motto of the internet is: "Anything goes."

In summary, the TICs have created a new operating environment for business in general and the financial institutions in particular which is characterized by a combination of speed, 100% connectivity, 0% editorial control, and non-stop social networking on a global scale.

Obviously, while for many a threat, simultaneously this represents an opportunity for those courageous enough to grab it, provided they have the genuine intention of establishing closeness and direct dialogue not only with customers and clients, but - with all of their other critical Stakeholders as well – on the same footing. In this new "Game without Frontiers", a competitive advantage can be gained by creating and sharing a corporate story that generates trust and credibility wherever the business operates – as long as you "walk the talk" of course.

Accept reasonable regulation

Regulation is coming back. Take or leave it. This is not an academic thesis open for intellectual debate. It is a fact of business life, and to stay with us long into the future.

Even the most outspoken advocates of unhampered free market dynamics grudgingly agree

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– Reagan’s and Thatcher’s policies of the 1980s are, to a large extent, to be blamed for our current crisis. Markets do indeed need to be closely regulated and monitored, and so do their protagonists. The sooner financial institutions accept this, the better they will position themselves to start rebuilding.

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Moreover, for the big financial institutions, developing and living a new model of relationship and interaction with critical stakeholders would increase their competitiveness in a world where basic product and service offerings are homogeneous and commoditized, copied or replicated, and distributed and commercialized at a lower price by new market players in the emerging economies. The vast majority of people in India, for instance, does not (yet) have account.

The banks’ capacity to influence their regulatory and operating environment is a critical component for future success. But doing it is not good enough. The “how” is as important as the “what”. Competitive advantage will be gained by being, and being perceived as, the Voice of Reason and the Model of Responsibility.

Review products, business models, and practices

Banks should accept this inevitable prerequisite for a fresh start, a new business model - assessing and deciding what is vital in terms of how they make money, and what is not. And yes, they will still be allowed to make money, just in a different way and maybe slightly less.

In a welcome initial step, UBS (ranked 15th on the G20 list) has recently announced concrete measures aimed at refocusing the bank’s activities away from high-risk, speculative, and sometimes downright exotic products, and back to the sound traditional business of wealth management. Next?, executive compensation models? Watch this space.

In order to improve society’s current perception of the financial sector, several core issues have to be addressed, but none will be as important as Ethics and Transparency which in future must permeate everything the financial sector does – whether it is in terms of senior managers’ pay, employee career mapping, internal control systems, corporate governance, clarity in product offerings to the market, and commitment to society as a whole. The financial sector cannot afford anymore to be seen by the community as a heartless, greedy, and ultimately self-serving money-making machine, plain and simple.

Without Transparency, there is no Credibility. Without Credibility, there is no Trust. Trust is not only the invisible and indispensible fabric holding together open societies. Trust also makes good business sense.

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Integrate lessons learned and proven structures and processes

Just as managerial skills and functional expertise can be transferred between industries, so can practices that have worked elsewhere. The "not-invented-here" syndrome is a major roadblock the financial services sector must overcome in order to be successful in its repositioning, a luxury they just cannot afford. Bankers should therefore look around for inspiration and example as they plot their return to respectability.

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Such role-model corporations, however, across all industries and sectors are few and far between. In Spain, for instance, according to the latest Future Brands report[10], consumers surveyed gave low grades to two out of three companies. Or is this result just the reflection of the newly-won consumer assertiveness and widespread suspicion towards the corporate world already discussed?

But herein lies an opportunity for banks to demonstrate tangible progress by assuming a leadership role. Improving their Reputation will eventually strengthen their Corporate Positioning and by extension their Corporate Brand, increasing competitiveness in the global marketplace and consequently boosting revenues. The challenge for any leading bank is to create or recreate an environment of trust and credibility for its organization, its resources, its business model, and its value proposition in terms of what it has to offer to the market and to Society.

And to do so will not necessitate re-inventing the wheel if they are willing to take a cue from companies that have redeemed themselves in the past.

The Reputation Institute[11] argues that for each five points of progress a bank or any other company gains in its RepTrack tool, the number of people who view the organization favorably will increase by 8.5%. For a company with a solid Reputation, 51% of its stakeholders will be inclined to believe any positive information about it, while only 25% will be willing to accept unquestioningly negative reports.[12] Remember the Favor Bank?

In other words, like corporations in any other sector, a bank with a good Reputation is more likely to enjoy the support of its stakeholders and therefore create value for its shareholders, to contract suppliers on much more favorable financial terms, to hire more talented and better qualified employees, and to generate stronger loyalty amongst costumers and consumers. In a nutshell, it becomes a more profitable organization in the long run – from which, dare we say it, management will again be

[9] www.ethisphere.com , whose claim, by the way, is: "Good.Smart.Business.Profit."

[10] www.futurebrand.es

[11] www.reputationinstitute.com

[12] PR Trust Barometer, 2011.

"The emerging Reputation-centric management model will require a profile of leaders that, while entrepreneurial, do not lose sight of the greater good of society over short-term (personal) gains. They must see themselves as servants of the common good rather than self-declared 'Masters of the Universe', accepting the same rules apply to everyone"

allowed to benefit financially, albeit within reason...

Attract new, untainted leadership

Sailing the Sea of Reputation requires captains who are able to read oceanic maps, handle a compass, navigate the currents, and, quite literally, recognize which way the wind is blowing. They must also have the personal attributes needed to gain the trust of their crews (read: employees), the confidence of their ship owners (shareholders), the support of the maritime authorities (regulators and governments), and the respect of the seafaring community at large (customers and society).

However, this responsibility does not lie only with the captain or, in corporate terms, the CEO. The rest of the Senior management team, the officers on board the company ship, has to live up to the same high expectations, and collectively they must chart the new course and steer the vessel accordingly.

For the financial services industry, the age of pirates and those that fell asleep at the helm must be over. The emerging Reputation-centric management model will require a profile of leaders that, while entrepreneurial, do not lose sight of the greater good of society over short-term (personal) gains. They must see themselves as servants of the common good rather than self-declared "Masters of the Universe", accepting the same rules apply to everyone. And they must not be guided by greed in their decision-making. With a long-term perspective exceeding quarterly reporting schedules and the current, ever-shorter shelf lives of CEOs, they will grow the business and increase its profitability, while mindful of its sustainability and the need not only to create, but to share value.

On top of all of this, they will personally project not only integrity, diligence, and thoughtfulness, but also optimism and a positive attitude. In the current economic crisis, when pessimism and fear of the future are so deeply engrained especially in the younger, the "lost" generation in many countries, the banks and their managers must lead in building confidence. Cynics and Dr. Dooms no longer fit the bill.

Handle legitimate grievances with respect and assume responsibility

The banking industry needs to hold up its hand and recognize where things have gone terribly wrong. Its leadership must awaken to the new reality in which value generation is directly linked to an organization's non-tangible assets, and in which the key things to do when interacting with stakeholders are no longer just to communicate and inform, but rather to participate and allow participation, in order to influence. One thing is for sure: stone-walling will not be accepted anymore.

Honest participation within a community of stakeholders is not about imposing one's own truth on others. It is an interactive exercise where, in order to earn trust and credibility, listening comes first. Only then can we put our own value proposal to those who are looking at us critically and scrutinizing who we are, what we say, and, most importantly, everything we do in order to verify if the being, the saying, and

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the doing are in line, are coherent, and make sense. Perception *is* Reality.

Once this principle is internalized and consistently acted upon, the banking industry will have won back its seat at Society’s table. Then it must demonstrate convincingly that it has embraced the new multi-stakeholder model of dialogue and participation, not just to further its own ends, but for the benefit of all. This will show the viability of the banks’ reformed business model. The proof, as always, is in the doing.

While it is a truism that *The Times They Are A-Changin’*, we are indeed witnessing a paradigm shift. The banking sector, more than others, must embrace the opportunities which today’s new technological, social, and societal environment yields for those that recognize and seize them – or ignore them at their own peril. Opportunity, they say, knocks but once. If it doesn’t, build a door.

6. THE LONG AND WINDING (AND SLIPPERY) ROAD TO REHABILITATION

Historians agree the one overriding cause for the outbreak of the French Revolution was the *intransigence of the elites*. Had King and nobility been more open-minded, reasonable, and sensitive to at least the most serious grievances of the people, they might have avoided their downfall and history taken a different turn.

While not facing the guillotine, for 21st-Century bankers a failure to take the steps suggested and share the corresponding story effectively will leave them in their current PARIAH status. But even embarking tomorrow on this road to rehabilitation will not guarantee immediate results as there are no quick fixes to rebuilding a Reputation. How long does a leopard need to change his spots?

By contrast, any actions or communications perceived to be cynical and reflective of the old way of doing things – the “here-they-go-again” syndrome – will backfire and provoke even stronger hostility. Simply put the burden of proof in the court of public opinion lies with the accused.

When you are in a hole, stop digging!

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