SPECIAL REPORT

Leadership in the Society of Change: Corporate Diplomacy, Reputation and Business Schools

Madrid, November 2013

1.REPUTATION, THE VALUE-GENERATING LEVER AND EXECUTIVE MANAGEMENT TOOL OF THE XXI CENTURY

Reputation management is becoming the critical executive tool for the management of companies and financial institutions, and even countries, in the XXI century[1].

This is so because it is the decisive lever for value generation by business and financial organisations and nations[2].

For this reason too, and in addition, the emergence of Reputation as the supreme executive lever of the XXI century and a value-generating tool for organisations will force business organisations and financial institutions to design a new form of leadership with skills and competence very similar to those of statesmen and the diplomats who represent them throughout the world[3].

This need in executive skills is essential in contemporary leadership, since its basic mission —the mission of these corporate leaders— to achieve their business objectives will be to seduce and maintain

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1 Cachinero, Jorge: "Por fin, la Reputación ya está aquí", **d+i LLORENTE & CUENCA** (2 June 2011) at www.dmasillorenteycuenca.com.

2 Jorge Cachinero led a multidisciplinary team in LLORENTE & CUENCA, made up of Antonio Llorente, Adolfo Corujo, María Cura, Iván Pino, Mauricio Gutiérrez and himself, which studied Reputation in Spain in a Special Report of d+i LLORENTE & CUENCA: "Diagnóstico y Recomendaciones sobre la revalorización de la Reputación de España" [Diagnosis and Recommendations on revaluation of Reputation in Spain] (February 2013).

In Manfredi, Juan Luis; Rubio, Rafael; and Alonso, Gabriel: Retos de nuestra acción exterior: Diplomacia Pública y Marca España. Diplomatic School, Ministry of Foreign Affairs and Cooperation (December 2012), Juan Luis Manfredi, one of the three publishers of the book, offered José Antonio Llorente and Jorge Cachinero the chance to publish a shortened version of that Special Report as a chapter of the book, under the title: "La Reputación de España como componente esencial de la ventaja competitiva de sus empresas en el mundo" [The Reputation of Spain as an essential component of the competitive edge of Spanish companies in the world], an opportunity greatly appreciated.

In addition, Juan Luis Manfredi and Jorge Cachinero recently published another Special Report of **d+i LLORENTE & CUENCA** on the same subject: "Diplomacia Pública y Reputación: Ideas para España" [Public Diplomacy and Reputation: Ideas for Spain] (22 May 2013).

Both special Reports and the book published by the Diplomatic School can be downloaded free from www.dmasillorenteycuenca.com

3 The authors of this report acknowledge their intellectual debt to Antonio Camuñas for his seminal work incorporating the concept of Corporate Diplomacy in the Spanish market for the first time.

the approval of each and all of the stakeholders that are critical for the success of their business model[4].

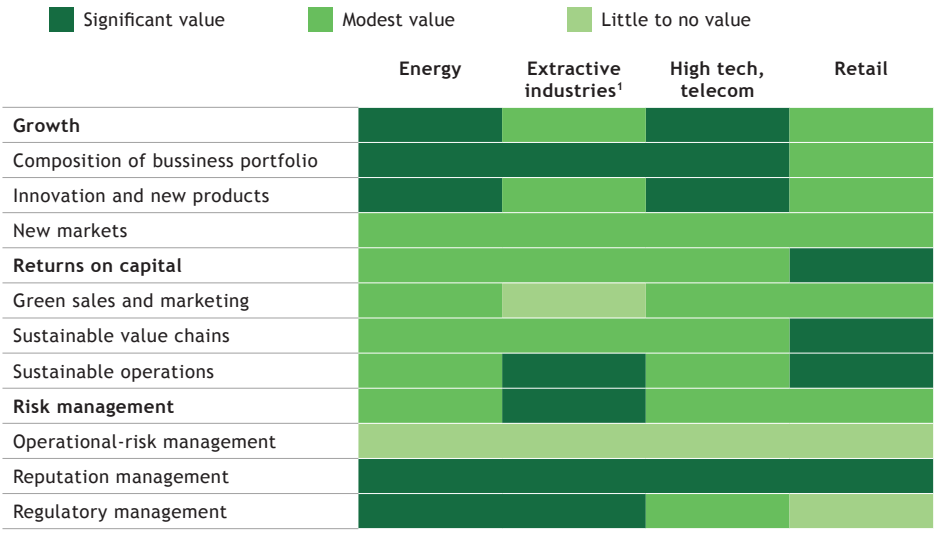
The assertion that Reputation is the value-generating executive tool of the XXI century may, at first sight, seem a little exaggerated, but considering the latest publications by the leading organisations in the study of new executive disciplines and in the counselling provided for the top strategic level of companies and financial institutions, one realises that it is not such an overstatement

"Reputation is the value-generating executive tool of the XXI century"

For example, *McKinsey*, one of the leading consultancies in strategic advice for customers, makes a recurring study called *McKinsey Global Survey* on "*The Business of Sustainability*", the 2010 results of which can be seen in graph 1.

FIGURE 1

POTENTIAL VALUE FROM SUSTAINABILITY ACTIVITIES OVER THE NEXT 5 YEARS, BY INDUSTRY



Source: The Business of Sustainability. McKinsey Global Survey 2010

In this study, McKinsey asked 3,500 top executives of major multinational companies in all sectors of business which levers they believed would generate the greatest sustainability and value for their business over the next five years.

The levers are listed on the vertical axis of graph 1 and the answers are organised according to the significant, modest or little-to-no value attached to each one by the 3,500 Chief Executive Officers (CEOs)[5] for the economic sectors in which they work, shown on the horizontal axis.

We can see in these results that the participants in this survey indicated certain levers —almost obvious, one could say— that are of priority interest for the top executives of companies to generate sustainability and value for their organisations. Those levers are necessary, but are no longer enough on their own. This is the case, for example, of the composition of the business portfolio, efforts made in innovation and new products and even the handling of relations with the regulatory authorities as markets come

4 Rey, Carlos; Cachinero, Jorge and Gutiérrez, Mauricio: "Una cultura al servicio de los *stakeholders*", **d+i LLORENTE & CUENCA** (24 April 2012) at www.dmasillorenteycuenca.com.

5 Cachinero, Jorge: "La transición a un nuevo CEO", **d+i LLORENTE & CUENCA** (18 October 2011) at www.dmasillorenteycuenca.com.

under increasingly closer scrutiny and control by the authorities, especially since the Great Recession.

However, apart from the above, what stands out most in this graph is that Reputation management is the only one of all these levers on which the top executives of companies have been polled that has obtained a unanimous response in all economic sectors for the extremely high value, critical nature and importance it has for all businesses.

This confirms the initial theory that Reputation management is becoming the supreme executive tool of the XXI century and the fundamental lever for generating value in companies and financial institutions.

The question is: Why has this situation arisen?

2. SIX CHANGES OF PARADIGM IN THE BUSINESS WORLD

In our modest opinion, this situation is the result of six changes of paradigm that have occurred in the business world during the transit between the XX century and the XXI century.

"This situation is the fruit of six changes of paradigm that have occurred in the business world during the transit between the XX century and the XXI century"

The first change is **the emergence of the Five Profit & Loss Account (P & L)** and, as a result, the appearance of stakeholders to whom companies and financial institutions must pay special attention in order to achieve their business objectives[6].

This Five P&L Account is merely a transformation of the business model of companies and financial institutions, which in the XX century were accustomed to rendering accounts to their shareholders, the owners of the companies, exclusively on their economic and financial performance.

Put more simply and perhaps a little provocatively, in the XX century companies operated and were sustainable as long as they were able to generate a healthy economic and financial return for their shareholders and owners, which in any case exceeded the opportunity cost of having those assets invested in other businesses or other assets.

To put it another way, the business model was considered to be working properly as long as the companies earned money and distributed a good dividend among their shareholders, even if, in doing so, they had

6 The authors are also in debt to Pascual Montañés, Professor of Strategy, IE Business School, for his views on this matter, set out in his book Aquí, ¿quién manda? Levantando el maña del poder de las organizaciones en el siglo XXI. Pearson & Prentice Hall/Financial Times (2011), in which Manuel Bermejo, with the chapter "Los Accionistas", and Jorge Cachinero, with the chapter "El regulador", are co-authors.

"That XX century model of company, which was answerable exclusively for an economic-financial income statement, is no longer sustainable long term in the XXI century"

caused dramatic environmental catastrophes or fatal accidents at their factories; or if their leaders acted without any ethics or principles; or if the companies' employees were not treated with a minimum respect for human rights or their physical safety, or did not have jobs offering sufficiently satisfactory training projects or attractive employability while they were working for those organisations.

That XX century model of company, which was answerable exclusively for an economic and financial Profit & Loss (P & L), is no longer sustainable long term in the XXI century.

This is due, among other things, to a combination of circumstances over the past few decades which have made that business model unsustainable.

Firstly, there has been strong social activism by citizens, who are increasingly more demanding in respect of the functioning, structure, organisation and conduct of companies and financial institutions.

Secondly, there is increasingly greater control and scrutiny by traditional media, especially thanks to the transformation that the new Information and Communication Technologies (ICT) have produced in companies, making each and all the details of the vision, mission, values and culture, strategic plans, structures and style of leadership of companies and financial institutions more transparent. Thanks to this power given by ICT, citizens submit companies to constant criticism and conversation through tablets, smartphones and other types of electronic support.

A third phenomenon that has no doubt borne an influence on the changing behaviour of business and financial organisations consists of the growing changes in the regulatory and operating environment in which companies operate. These changes have been brought about by pressure from politicians who, when all is said and done, respond to the urges, demands and expectations of society, which they perceive directly or through the media and, nowadays, also through conversations among citizens through the social networks.

Finally, —to avoid seeming over cynical in this argument—, the change towards that Five P & L Account has also taken place because, fortunately, a new generation of corporate leaders is emerging with greater social awareness and shrewd enough to understand the role played by business organisations and financial institutions, and the role they are expected to play, as citizens within the fabric of open, contemporary societies.

In short, that combined pressure has forced a shift from the model

"That combined pressure has forced a shift from the model of a single economic-financial income statement to a Five-Part Income Statement"

of a single economic-financial P & L to a Five P & L Account, in which the first and foremost is, naturally, still the economic and financial statement.

In fact, this is what gives a business model a sense of survival, because logically a business model unable to provide its owners or shareholders with a healthy return would not make much sense in a market economy. Yet over the past few decades another four decisive income statements have appeared on the scene, on an even footing with the first statement, to convert a business model into a project that is sustainable in the long term.

The second statement is concerned with governance, ethics, principles and healthy leadership of organisations. In other words, it is concerned with how things are done.

The third statement is concerned with environmental protection and the care taken to mitigate the impact of the human activity performed by each business organisation and financial institution on the environment.

The fourth statement is concerned with the management of people and talent in organisations and, by extension, any people forming part of companies' value chain. In other words, how they are hired and paid, their working conditions, what expectations they have for furthering their careers and what level of training and employability they reach within those organisations.

And finally, there is a fifth statement concerned with social interaction and the contribution made by companies and financial institutions, as citizens, to the societies in which they operate and perform their business activities.

This model has naturally been accompanied by the mushrooming and, in many cases, organisation of stakeholders. The supreme pressure groups of XX century organisations —which were essentially the shareholders— have made way for the numerous, varied, complex pressure groups of the XXI century organisations, namely the stakeholders.

Therefore, in this operating environment with numerous, varied stakeholders and the obligation to answer for a Five P & L Account, rather than a economic-financial P & L, Reputation has emerged as a critical executive lever of value generation and executive management for companies in the XXI century.

This is the context in which the management of business organisations and financial institutions are being forced to take on skills and competence that are more similar to

the duties exercised by a statesman or diplomatic duties than the mere management of processes and procedures as in the XX century.

The second change of paradigm in the business world in the early XXI century is that **Reputation is an asset with economic value**, in euros and cents, for companies and financial institutions and can, moreover, be measured[7]. It is not merely an academic or philosophical creation.

Graph 2 —obtained from a source which cannot be suspected of not knowing how markets work, *Standard & Poors 500*— shows in a graphical, visually attractive form, the evolution from the last quarter of the XX century to the present of the criterion followed by markets for establishing the value of companies.

Basically, in the XX century the market value of companies was established essentially on the basis of their tangible assets —factories, products, patents, supply chains, logistic structures, sales and commercial forces, etc.— and to a very small extent by evaluating their intangible assets.

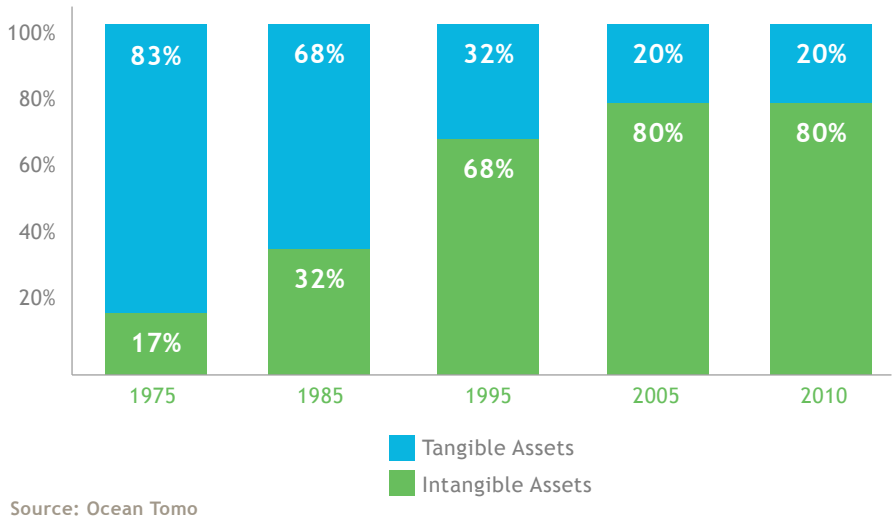
This situation was radically transformed at the turn of the century and, as shown on the right of graph 2, the most important factor when assessing the market value of companies is now their intangible assets, which are essentially brand and Reputation.

In fact there are now a large number of indexes — *FTSE4Good, Dow Jones for*

"Reputation is an asset with economic value, in euros and cents, for companies and financial institutions and can, moreover, be measured"

FIGURE 2

COMPONENTS OF S&P 500 MARKET VALUE



Source: Ocean Tomo

7 The authors acknowledge the extraordinary vision of Professor Charles Fonbrum for anticipating this thesis and developing universal solutions for measuring the Reputation of companies, financial institutions, cities or countries through the Reputation Institute. The authors also acknowledge the pioneering work done by Ángel Alloza in Spain to promote the importance of Reputation management for companies and financial institutions and his leadership through the Corporate Excellence - Centre for Reputation Leadership, with the commitment of its trustees (BBVA, Caixa, Iberdrola, Repsol, Santander and Telefónica) to achieve this purpose. Jorge Cachinero is deeply honoured by the invitation to sit on the Advisory Board of that organisation.

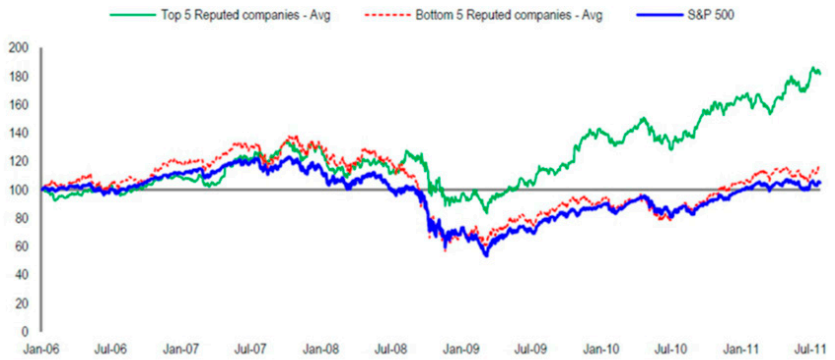
Sustainability and many others— that reflect the increasing sophistication of markets when assessing the business models of companies and financial institutions and the growing, decisive role of intangible assets, especially Reputation, in this evaluation process.

Graph 3 shows an even more direct and tangible representation of the above argument because it shows how, during the Great Recession, i.e. since 2008, companies which have protected, cultivated and, in short, had an above-average Reputation —represented by the green line on the graph— are valued higher by the markets than those with a worse or below-average Reputation, according to *Standard & Poors 500*.

"The economic value of Reputation is directly associated with the trust that organisations are able to generate within society in general and among stakeholders in particular"

FIGURE 3

THE MARKET RETURNS TO REPUTATION (2006-2011): A BACKWARD LOOKING VIEW



Source: "*The Tangible Value of Corporate Reputation*", Charles J. Fombrun y Jonathan Low, Communication World, Nov-Dec 2011

Therefore, Reputation is unquestionably a lever for generating a return on investment and can be quantified from an economic point of view.

There are also institutions, such as the *Reputation Institute* — as shown in Figure 4— which reveal a proportionally direct relationship between improvement of an organisation's Reputation and the recommendation made by stakeholders and public opinion in general to buy its products or invest in its assets.

Therefore, it has been proved that the attitudes and behaviour of stakeholders and the public at large are directly associated on the markets with companies having a better Reputation.

In short, the economic value of Reputation is directly associated with the trust that organisations are able to generate within society in general and among stakeholders in particular.

Another way of expressing the same concept can be seen in Figure 5.

The columns on the left show the basic qualities traditionally used to measure companies' success when the only income statement taken into consideration was the economic-financial P & L: volume of income or size of market capitalisation.

Yet in the XXI century, those two criteria are not sufficient on their

own to assess the strength of business models.

The market is using different systems to measure the performance of business organisations and financial institutions based on qualities which are becoming increasingly more important —not replacing the previous qualities but supplementing them—, such as the desire to work or admiration roused by the companies among stakeholders and public opinion.

Prestigious organisations repeatedly make this kind of scales because markets do not wish to measure companies only by their size or market capitalisation, but also by all the components of their Five P & L Account.

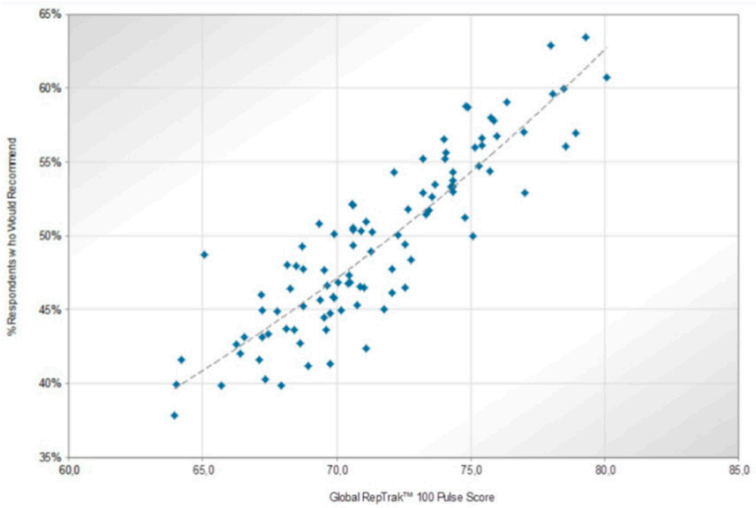
In other words, companies are to be valued in terms of the basic components generating the trust of consumers, societies, regulators, shareholders and the public opinion in general.

In short, Reputation is an executive value-generating lever. When it is included within the strategy and resources are assigned to it, Reputation is a key factor of competitive edge. It cannot be copied, it does not run out as a result of bad commercial planning and it does not flee with departing executives[8].

Firstly because, as has been well documented, Reputation helps to increase business profits by improving stakeholders'

FIGURE 4

IF A COMPANY IMPROVES ITS REPUTATION BY 5 POINTS, IT WILL INCREASE ITS RECOMMENDATIONS BY 7.1%



Source: Estudio Global RepTrakTM 100, 2012.

FIGURE 5

+ Income	+ Value	+ Desired	+ Admired
Wal-Mart	PetroChina	Google	Apple
Exxon Mobile	Exxon Mobile	BCG	Google
Chevron	Microsoft	SAS Institute	Berkshire Hathaway
ConocoPhillips	Bank of China	Wegmans Foods	Southwest
Fannie Mae	Wal-Mart	Edward Jones	P&G
General Electric	China Bank	NettApp	Coca Cola
Berkshire Hathaway	BHP Billiton	Candem Property	Amazon
GM	HSBC	REI	FedEx
Bank of America	Petrobas	CHG Healthcare	Microsoft
Ford Motor	Google	Quicken Loans	McDonald's
Source: **Fortune 500**	Source: **PWC**	Source: **BPW**	Source: **Fortune**

8 Cachinero, Jorge and Manfredi, Juan Luis: "Tecnocracia o política?: Reputación, Transparencia y Liderazgo", **d+i LLORENTE & CUENCA** (March 2012) at www.dmasillo-renteycuenca.com.

"The Reputation and trust that is generated also provide the best protection for minimising risks in crisis situations"

perception of the company's value. Secondly, because it has a bearing on customers' recommendations of the company, favouring informal marketing. Thirdly, because it strengthens the growth of the business model by improving the rates of attracting custom and customer loyalty and by facilitating access to markets and the commencement of business operations. Finally, because it puts up entry barriers to possible rivals and promotes the retaining and motivation of own human capital[9].

Moreover, the deposit of credibility, Reputation and trust that is generated also provides the best protection to minimise risks in crisis situations, which all organisations have to face sooner or later and more or less severe.

The better their Reputation, the better the treatment received by organisations from their stakeholders and society on the whole in those times of difficulty, and the more readily they are given a second chance to recover and continue operating on the market.

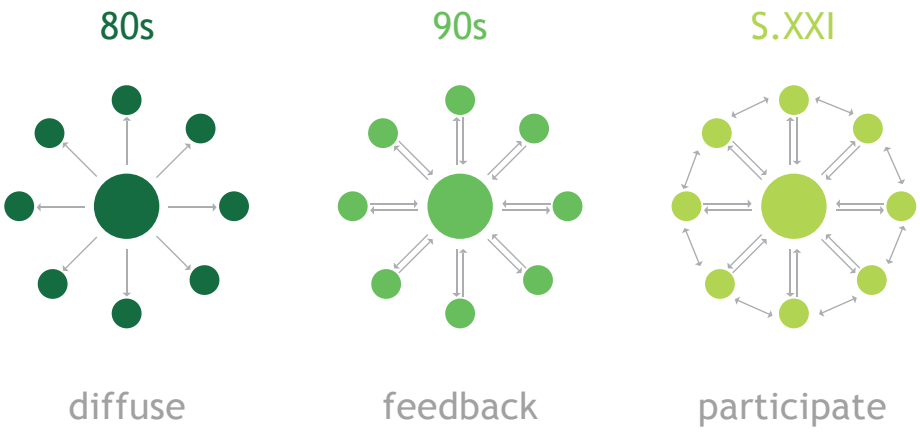
The third change of paradigm refers to **the revolution of Information and Communication Technologies (ICT)**[10], as shown in Figure 6 below.

The ICT revolution has made citizen relationships more democratic and opened the doors to a more or less organised extension of the social activism of communities.

The image on the left of Figure 6 shows, very simply, the role played by companies in the XX century, within their natural habitat, in everything related with the information on their business model and company. Companies had a critical central position, represented by the size of the dot in this figure.

The companies decided how and when information on their business was to be disclosed and distributed to anyone who might be interested in it.

FIGURE 6



9 The authors use these three powerful arguments, which are developed by the *Reputation Institute* and they feel indebted to this organisation for their use.

10 Regarding measurement of online Reputation: Alloza, Ángel; Pino, Iván; and Cachinero, Jorge: "¿Existe la Reputación online? Tres respuestas y más incógnitas", **d+i LLORENTE & CUENCA** (March 2012) at http://www.dmasillorenteycuenca.com.

It was the companies that set the pace and decided on the quality, quantity and details of that information, which was, moreover, distributed purely for propaganda purposes, if readers will pardon the expression for the sake of argument. In other words, it was used to persuade or convince by including information controlled by the company in the traditional information channels.

The image on other side of this figure depicts the world in which we live today and, thanks to ICT, that point representing business organisations and financial institutions has become relatively smaller because they have become less critical.

They are now permanently surrounded by conversation among those who are interested in the activities of those organisations, albeit purely out of curiosity, and the companies and financial institutions are unable to control what, when or how they are talked about.

To a certain extent, what has happened is that business organisations and financial institutions have lost their power over transmission and control of the information concerning them.

Moreover, this behaviour has been generated at the same time as, and is directly related with, the severe crisis of the business model of traditional media, which have not yet completed the full shift from a model that is becoming obsolete to another future model raised on the base of digital, conversational, socialising communication.

This is why the media, even those specialising in the business or financial sector, have also to a large extent lost their role as filter, interpreter or prescriber, which they played in the past in the relationships between business and financial organisations and the environment in which they operated.

This phenomenon of democratic relationships and the emergence of social activism between inter-connected communities has appeared in many cases in recent years and not only in the world of politics.

The revolutions in North Africa, which began in 2010, could be mentioned as a paradigm of this phenomenon, although only as a reference since it is not the subject-matter of this paper.

We do not need to prove the point by moving so far from the scope of this essay.

Large enterprises have on numerous occasions had to deal, sometimes rather clumsily, with the power which this mobilisation, this activism and this relationship gives individuals in respect of large enterprises through social networking and the new communication vehicles and mechanisms.

"Business organisations and financial institutions have lost their power over transmission and control of the information concerning them"

"Just like David and Goliath, individuals can knock down —or at least bring to their knees— the biggest giants in the corporate and financial world through the power gained by citizens through ICT"

It is worth mentioning, by way of example, the case of *Bank of America*, the principal bank in the USA, and Molly Katchpole, a poor girl who worked part-time as a nanny to pay for her studies.

In autumn 2011 Molly was informed by her bank that it was going to charge her a commission of 5 dollars every month for using her debit card. That is, for using her money which she had deposited in the bank, not to cover the risk associated with the use of a credit card.

Moved by this commercial and marketing decision of the bank, apparently within the spirit of the exclusively economic and financial P & L of the XX century, Molly Katchpole —at that time not known outside the social circle of her family and friends and now known all over the world— recorded herself with a pair of scissors cutting up her *Bank of America* credit card and put the video on YouTube. In just a few days in the autumn of 2011 that video became one of the most widely distributed viral phenomena in the USA.

Molly also began a petition on the platform Change.org to collect signatures against the bank. This initiative was also enormously successful and she obtained over 300,000 signatures.

Bank of America reacted fast and in just a few weeks it sent a new letter out to its customers informing them that it had reversed its decision to charge them every month for using their debit card[11].

Without wishing to be romantic or utopian, what this example shows us is that, just like David and Goliath, individuals can knock down —or at least bring to their knees— the biggest giants in the corporate and financial world through the power gained by citizens through ICT.

The fourth change of paradigm is one on which Professor Ángel Núñez from IE Business School speaks clearly and very persuasively[12].

Professor Ángel Núñez upholds that we are currently in full **transition from demand markets**

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11 Specifically regarding Reputation problems in the financial sector: Cachinero, Jorge and Gietz, Axel: "*Holding to Account with Nothing to Bank On Anymore. The Reputational Freefall of the Financial Services Industry: Why It Is Unprecedented and How It Can Be Reversed*", **d+i LLORENTE & CUENCA** (15 December 2011) at www. dmasillorenteycuenca.com.

And regarding the food industry: Cachinero, Jorge; Matesanz, Tomás; Pino, Iván; Peña, Luis Miguel; Herrera, Cristóbal; Gutiérrez; y Gomariz, Antonio: "*Reputation Management and Food Alerts*", **d+i LLORENTE & CUENCA** (21 September 2012) at www.dmasillorenteycuenca.com.

12 Ángel Núñez, Professor of Marketing, IE Business School, was recommended by Manuel Bermejo to Jorge Cachinero, who witnessed first-hand during a working session at LLORENTE & CUENCA a brilliant, fascinating presentation in which this change of paradigm was argued, together with others that were just as inspiring. The authors have an intellectual debt to Professor Ángel Núñez for this.

to the extended consolidation of supply markets.

Professor Núñez usually backs his theory with a very attractive and visually powerful argument: he invites anyone from his audience to type the word "*brands*" into any Internet search engine and, after obtaining the results, to go to the images section of the search engine.

One example of the result of images found in this search is shown in Figure 7, which, according to Professor Ángel Núñez, represents a world in which brands are losing their differentiation and distinction capacity on the market, practically becoming "labels" rather than real brands. Consumers' purchasing habits are becoming increasingly more sophisticated, ignoring the supposed value traditionally associated with brands.

"Consumers are now making their own decisions on what, when and how to consume goods or services and are not necessarily submitted to the leadership that the major brands traditionally exercised"

Certainly this and other similar images confront us with a huge blotch of colours and silhouettes in which the brands of numerous categories of consumer goods, especially FMCG (Fast Moving Consumer Goods), are changing. This makes it increasingly more difficult to distinguish them and clearly identify the value promise and UPS (Unique Selling Proposition) that they offer.

Consumers are now making their own decisions on what, when and how to consume goods or services and are not necessarily submitted to the leadership that the major brands traditionally exercised over consumers' minds in the past.

Related with the two changes of paradigm mentioned above, the author Bill Lee upholds that **marketing is dead**[13], which is the fifth change of paradigm contemplated here.

According to Lee, marketing is dead because consumers increasingly ignore traditional marketing. Moreover, the ICT revolution has destructured the platforms and carriers that previously caught consumers' attention during their leisure and entertainment activities, through which they passively imbibed that advertising or traditional marketing.

FIGURE 7

13 Lee, Bill: "*Marketing is Dead*", Harvard Business Review (August 9, 2012).

"If companies want to maintain a value-generating relationship for their business and their consumers, they must make an effort to bring their promise of value in line with their customers' and consumers' needs and expectations"

Traditional televisions are not used by the new generations for leisure and entertainment. They now have access and meet their needs for information, entertainment and relationships using mobile phones, tablets and electronic devices, where they download, share, listen and watch without being submitted to the impact of traditional advertising.

The top executives of large enterprises have realised now that their marketing managers have lost their power, from the point of view of traditional marketing as described here, because they have lost the ability to increase the value of brands and make them important for the market through the usual channels and carriers.

If companies want to maintain a value-generating relationship for their business and their consumers, they must make an effort to bring their promise of value in line with their customers' and consumers' needs and expectations.

They should, therefore, incorporate their commercial activities in those communities and conversations in which their potential customers participate, seek influence —rather than *carpet bombing* through large advertising campaigns in the cinema, on television or on large billboards—, stress the shared value of their business models and, in short, involve consumers, customers and stakeholders in the whole story —"*storytelling*"—, and especially in the entire performance of the organisation —"*storydoing*"[14]—, referring to the presentation they make of their value promise to society.

Finally, the last change of paradigm produced in the world on the changeover from the XX to the XXI century is related with the origins, effects and long-term consequences of "The Great Recession".

"The Great Recession" was initially a financial crisis unleashed in the United States of America as a result of excessive deregulation of the financial sector and the confusion between commercial banking and investment banking.

This financial crisis subsequently turned into a sovereign debt crisis in Europe.

Then, as a result of the combination of the previous two, the northern hemisphere in the West was plunged into a severe economic crisis which is causing a real tsunami in the form of a social crisis, the painful effects of which are going to take some time to shed.

However, if we want to find a synthetic way of conceptualising and defining what has happened

14 Montague, Ty: "Is Your Company a Storyteller? Or a Storydoer?", Business Week (3 September 2013).

"Freedom, the great instrument of progress, can lead us to the abyss unless it is firmly founded on and sustained by a rich, creative, critical culture and spirituality in constant renovation"

in the most developed countries in the West since 2008, we must use the concept of the *triple crisis*.

The epidermis of the problem is the financial crisis —first crisis— which, as usually happens, permeates through to affect individuals and companies —second crisis—.

However, behind and below the first two a deep crisis of values can be observed —third crisis—.

We quote the reference to the "Great Recession" made by the distinguished writer and Nobel Prize-winner Mario Vargas Llosa, saying that: "This crisis is not exactly a purely financial crisis. Behind the behaviour of the large bankers and large entrepreneurs, there are degraded morals, deeply corrupted by greed. And that is a terrible form of ignorance. All the great liberal leaders talked about that, from Adam Smith to Hayek or Popper. They said: 'Freedom, the great instrument of progress, can lead us to the abyss unless it is firmly founded on and sustained by a rich, creative, critical culture and spirituality in constant renovation'"[15].

One unquestionable effect of the *triple crisis* is in turn — and this is the sixth and final change of paradigm of this series— **a deep crisis of trust and leadership combined**[16].

In the middle of this crisis of trust, one could be tempted to reach the conclusion that no-one trusts anyone anymore, that people are full of cynicism and scepticism when it comes to banks or large enterprises.

However, there is actually still a trace of trust in people.

This is basically an invitation to introspective thought which should involve the "*captains of industry*"[17] and finance, the management of business organisations and financial institutions, if they want to organise an intelligent road map to overcome the challenges of the present.

As revealed in surveys, such as that made regularly by Metroscopia in Spain for the daily newspaper El País, people still have some trust left.

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15 Conversation between Blanca Berasátegui and Mario Vargas Llosa at www.elcultural.es (3 September 2010).

16 Once again, in this case regarding the crisis of leadership: Cachinero, Jorge and Manfredi, Juan Luis: "¿Tecnocracia o Democracia?: Reputación, Transparencia y Liderazgo", **d+i LLORENTE & CUENCA** (29 February 2012) at www.dmasi-llorenteycuenca.com, subsequently summarised with the same title for the journal UNO, flagship of **d+i LLORENTE & CUENCA**, number 7 ¿Tecnocracia o Democracia? Gestión y Representatividad (2012), which can be downloaded free from www.revista-uno.com.

17 The expression "*Captains of Industry*" was coined in th UK during the Industrial Revolution, referring to the business leaders and leaders of the business world who had not only amassed a fortune through their business endeavours, but also contributed substantially to improving the societies in which they lived. In other words, the Bill Gates of the XIX century.

"That trust, thin on the ground and, consequently, even more precious than ever, is placed in those who are directly and materially seen and perceived to be acting in favour of others"

That trust, thin on the ground and, consequently, even more precious than ever, is placed in those who are directly and materially seen and perceived to be acting in favour of others: researchers, scientists, physicians, civil guard, teachers at public educational establishments, police, universities, armed forces, NGOs, charity organisations and religious social work, and small and medium-sized enterprises.

However, people have no trust at all at present in the other institutions or social entities belonging to the three major powers of our democratic societies —executive, legislative and judicial—, large enterprises —Spanish or other multinationals—, unions, employers' organisations, banks, the church, bishops, political parties, etc.[18]

This is a state of opinion that business organisations and financial institutions would do well to bear in mind because although at first sight it could seem like a threat, it is actually a marvellous opportunity for business and financial leaders who sincerely and intelligently want and hope to build or veer their business models towards an authentic model of shared value creation[19], so that people can project towards them the little trust they still have, in spite of the havoc wreaked among us all by the Great Recession.

In short and in view of this panorama, Reputation management is, as mentioned at the beginning of this text, unquestionably becoming the critical executive lever for management and value generation in the XXI century. Its mission is to look after, protect and develop what is coming to be recognised as the most important asset —Reputation— of business and financial organisations in this century and of nations and cities[20].

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18 Regarding the Reputational impact of pay policies for executives of companies and financial institutions: Cachinero, Jorge: "Retribución de Directivos y Reputaciones de Organizaciones", **d+i LLORENTE & CUENCA** (3 September 2012) at www.dmasillorenteycuenca .com.

19 Porter, Michael E. and Kramer, Mark E.: "*Creating Shared Value. How to reinvent capitalism - and unleash a wave of innovation and growth*", Harvard Business Review (January-February, 2011).

20 The results of the *Reputation Institute* on the Reputation of nations —Country RepTrak®— and cities have become a universal standard. So much so that in Spain, the Real Instituto Elcano, leading Spanish *think-tank* in the study of international relations, chaired by the prestigious Professor Emilio Lamo de Espinosa, has set up a task force called "Observatory of Spain's Image Overseas", headed by Professor Javier Noya, which regularly uses the *Reputation Institute's Country Rep-Trak®*. Jorge Cachinero is deeply honoured at having been invited to be a member of that task force. Juan Luis Manfredi is deeply grateful for the trust placed in him by the Chairman of Real Instituto Elcano, Professor Emilio Lamo de Espinosa, and the Director Professor Charles Powell, to enter a research collaboration relationship with that institution. Jorge Cachinero and Juan Luis Manfredi express their heartfelt gratitude to the former ambassador Rafael Estrella, Vice-Chairman of *Real Instituto Elcano* for his permanent support.

"The leaders heading companies and financial institutions must adopt the shared-value creation model while necessarily facing up to the age of uncertainty and chaos"

3. CORPORATE DIPLOMACY AND LEADERSHIP IN THE XXI CENTURY

In this context, the leaders heading companies and financial institutions must adopt the shared-value creation model while necessarily facing up to the age of uncertainty and chaos.

MBAs and executive development programmes have for years offered management models and planning tools.

The case method is based on evidence, proposes a path of thought and offers a set of plausible solutions. There is no single solution to the case, but there are guidelines to learn how to manage them. The scenarios are probable. So in the second half of the century we learnt how to manage companies and organisations, endeavouring to assimilate the advantages of the scientific method and apply them to the business environment.

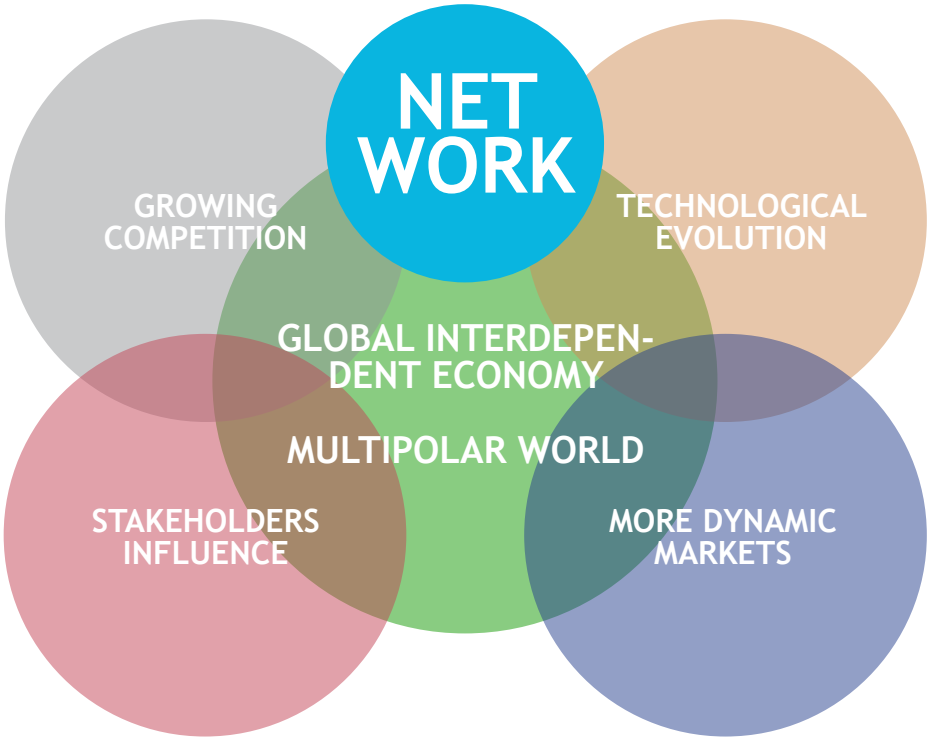
The fathers of management developed this model and we learned it.

Taylor (1922) thought that managers could design scientific operations in the company, whereas Fayol (1925) believed that the secret of business success lay in planning. To quote the most well-known of all, Drucker indicated in 1954 that executives should set objectives, organise the distribution of work, manage and motivate employees, measure the results and manage the resources.

But that world has ended.

As Professor Manuel Bermejo pointed out, we live in the society of change —a concept introduced in his book Hacia la empresa familiar líder[21]—, characterised by globalisation and the development of a multi-polar world with different cosmo-visions, enormous business dynamism, increased competitiveness, strong impact of information technologies and growing prominence of stakeholder management.

FIGURE 8



21 Bermejo, Manuel: Hacia la empresa familiar líder. FTPrentice Hall. (2008).

"In the new economic environment, we must learn to manage uncertainty"

We cannot confuse the risk —the distribution of probabilities of an event occurring is known— of the second half of the XX century with the uncertainty — the distribution of the risk is not known, or even the size of the risk— of this new time in history.

In the new economic environment, we must learn to manage uncertainty.

Any executive who thinks he can predict the changes in his economic sector is increasing, not reducing, the risks.

Ignoring permanent change is a sure road to bankruptcy. It is not possible to eliminate the risk, but we can reduce exposure to it by acquiring new expertise and skills. This is where executives might understand that their management makes a difference.

4. THE NEW EXECUTIVE SKILLS

The skills now required of executives are different.

It is not a question of burying the financial statements or denying the value of the ROI, ROE, ROA or any other metrics used to measure results. These capacities are assumed of a good executive.

But something else is now required. Executives now need to be able to speak and communicate in public, know the extent of the brand and digital identity, understand the multi-cultural aspect or value of digital operations, be enterprising and innovative in the business, protect the organisation's Reputation or be capable of establishing ties with rivals. The new skills are channelled through three ideas: capacity to make a proposal and define a mission; communication of goals to employees and stakeholders to channel efforts; and motivation of a team so that its members feel part of a project.

Henry Mintzberg[22] reached the same conclusion: managerial tasks are important, but the capacity to create value through leadership, negotiation and communication with one's surroundings is even more important.

The conditions for operating, and being successful, on the market have changed.

There is a prevailing need to understand the network society, in which the value of an organisation does not lie exclusively in what it has or what it can do — classical competitive edge— but in its ability to establish strong, international networks geared to the business. This leadership consists, therefore, of the capacity of attraction, selection and identification of talent.

As opposed to the protection of a patent or attracting of a new

22 Mintzberg, Henry: *Managers Not MBAs: A Hard Look at the Soft Practice of Managing and Management Development*. (2005).

"Only companies that incorporate innovation in their processes, management and organisation will survive"

customer, this type of network generates a social capital which cannot be replaced or disputed and is not lost when an executive leaves to join a rival.

Time will tell the consequences of the management reshuffle in Apple and Burberry following the departure of Angela Ahrendts. If the digital transformation undertaken by Burberry comes off, the consequences of Ahrendts' departure will be smaller.

One of the most significant new skills is anticipation, which consists of designing sound alternatives that generate new business channels and a gradual transformation of the types of enterprise and their management.

These strategic decisions are neither simple nor pleasant.

Yet there is no alternative. How much crisis can we bear before we set about making the substantial changes that our organisation needs? How much Reputation can we sacrifice before we understand that it is part of the core business?

Only companies that incorporate innovation in their processes, management and organisation will survive. Not through an innovation sub-committee, but by considering innovation a permanent part of the executive's job. Although not common, that is how Reputation can be incorporated in executive innovation.

At present, that capacity for anticipation consists of creating future alternatives and handling the real options for creating business, understanding the value of real-time data[23] and the influence of collective intelligence on decision-making —Does Twitter affect my business?— and, in general, long-term visibility —What technologies or transformations will affect my P&L account and in what time scale? —.

Meanwhile, the executive's role now also includes developing the company's Reputation strategy in its dealings with public authorities. Let's have a look at his sector: How many decisions are imposed by law? How many depend on European Directives or decisions of the European Parliament? Within the European framework, the lawmaker is still an important player in company performance.

For this reason, value is generated for the company when the executive is able to handle conflicts arising naturally in its relations with the authorities and any internal tensions generated within the organisation.

The instruments are intangible —Reputation, credibility, transparency, trust — and are best understood beyond the confines of the company. If the public opinion or authorities distrust an organisation, it can lose its social and even material licence to operate on the market. There

23 *Big Data.*

"Corporate diplomacy, formerly relegated to public relations or institutional relations, is now one of the principal tasks of any executive"

is a growing interest in the social impact of business decisions and executives must be ready to give a response that is coherent with the company's mission. These ideas can be extended to governments and, certainly, to political, union and business organisations. No influence and even less leadership is possible without Reputation.

Corporate diplomacy, formerly relegated to public relations or institutional relations, is now one of the principal tasks of any executive. In public circles, governments now consider Reputation-building a priority, knowing that investments, exports and other economic decisions affecting a country's GDP depend on it.

It is not a task that can be delegated and nor can it be submitted to the stress of urgency. Prevention, projection of Reputation, exploration of new opportunities, planning — vision, mission, values— and the training of new employees cannot depend on third-party agendas and have a direct bearing on the income statement. For this reason it has become one of the principal tasks of executives who seek to meet the objectives established by the organisation.

Corporate diplomacy ignores the short term because executives understand that in the new context what can save the organisation are alliances and networks. This expertise in conversing with different interest groups reveals executive maturity in that intelligence is consolidated to manage and develop coalitions of common interests with third parties. Cheating erodes leadership capacity.

Corporate diplomacy entails embracing real, rather than tailored globalisation. This means that we do not need to follow over and again the pre-established models of Anglo-Saxon capitalism and ideas from the *Ivy League*[24].

Is there another, richer, more diverse globalisation? How much do we know about Acer, Orascom or Hyarat Forge? Or about the management models of Samsung, Arcor or Suzlon?

A quick lesson: they are corporations that have not based their strategies on lowering unit production costs, but on creating a continuous, scalable growth model, adapted to suit their own unstable environments. If a company now plans to operate on these international markets, it must learn that its value proposal will have to compete with these emerging giants.

The WTO has 135 members. The BRIC (Brazil, Russia, India, China) will shortly be overtaken by the double MIT (Mexico, Indonesia, Turkey and Malaysia, India and Thailand), which have thousands of infrastructure projects and are forming the new world middle

24 On the crisis of the current model, Haque, Umair: "*This Isn't Capitalism - It's Growthism, and It's Bad for Us*", Harvard Business Review (28 October 2013).

"Prestige, leadership of international alliances and trust have direct effects on the management of the company and transformation of the production model"

class. This is also occurring in South Africa and South Korea.

These countries individually contribute around 1% of the world GDP and are net investors. Sixteen of the twenty largest cities in the world are situated in these countries and 25% of the principal global companies.

And they are still demanding telecommunications, energy, transport, water and waste management and social services. Spanish SMEs have some knowledge of these areas but they must now learn to compete in other markets.

In the company, this understanding of globalisation is evidence in the development of commercial intelligence. Prestige, leadership of international alliances and trust have direct effects on the management of the company and transformation of the production model.

Family businesses should not reject their management model, although they must be open to new channels for economic development that can compete in diverse globalisation and generate opportunities to pull out of the crisis by different means from those currently used.

That is where global competition comes in: not only are these markets interesting for exports, but they are also excellent investors. In those countries, an executive in a global company establishes a strategy that is aimed at other executives and investors.

5. A 5I COMPANY, AN IDEA OF OUR TIMES

'5i companies', as they are called by Professor Manuel Bermejo [based on the first letter of the Spanish words for their 5 essential qualities], are companies that grow in turnover and profitability in times of severe crises[25]. And they achieve this thanks to their special skill in handling five concepts:

- **Market intelligence**, which is necessary to correctly interpret changes in their clients, rivals or on a macro level and adapt with firm value proposals that are coherent with the changes perceived. Agility and flexibility are, therefore, becoming increasingly important.

- **Innovation:** companies that are naturally able to think outside the box and break taboos or paradigms that prove obsolete. They work very creatively on processes or products, with their sights always set on improving the aggregate value of what they offer their customers. Innovation is also applied in the management of people and these '5i companies' know that the greater the talent the more competitive they will be.

25 Bermejo, Manuel. "Empresas 5i: suyo es el futuro", Family Business (25 August 2013) at http://family-business.blogs.ie.edu/2013/08/

"5i companies' feel they are running a marathon, not a 100m flat race"

- **R+D:** '5i companies' feel they are running a marathon, not a 100m flat race. With a long-term vision they understand that they must invest major resources to acquire proprietary products or technologies, because when these efforts are geared towards customers, the resulting competitive edge is very powerful. It is thus possible to build sustainable business models.

- **Internationalisation:** '5i companies' are convinced that globalisation offers clear opportunities and devise ways of strategically taking them through multi-level actions. They naturally address internationalisation policies from the point of view of business development. But at the same time they maintain a global vision to capture talent from outside the company's home country, because diversity brings significant new skills and capacities for the company, or the opportunity to build the organisation's value chain with a global perspective.

- **Institutionalisation:** '5i companies' know that the management of intangibles is also critical to consolidate sustainable models. Starting with corporate governance. They create strategic reflection posts, thinking not only of urgent aspects, but also important ones, apart from looking after other aspects which apparently don't bring the money in, such as Reputation management.

Following this reflection, it is interesting to read the book written by Giuseppe Tringali, chairman of Publiespaña and CEO of Mediaset España, 15 Casos de Éxito Probado[26] [15 cases of proven success], which looks at companies operating in Spain during the 2008-13 crisis with obvious success thanks to their particularly wise handling of variables such as those mentioned above.

6. THE ROLE OF BUSINESS SCHOOLS IN GENERATING LEADERSHIP IN THE XXI CENTURY

This entire transformation of executive skills is paralleled by the need to rethink the role of business schools.

The North American model, accepted by European schools, with their work routines, programmes and methodologies, needs to be revised. We cannot go on teaching —and learning— as if globalisation, technologies, the ethical problems of financial capitalism and conflicts of interest or the current economic crisis had never happened.

26 Tringali, Giuseppe: 15 casos de éxito probado. Aguilar (2013).

"Business schools have a responsibility to take part in the transforming leadership of society"

This executive maturity we have mentioned also requires business schools to recover a humanistic view of companies. Management is not scientific, we know that now, but it is certainly not neutral. Every decision, every action and every omission has consequences and even externalities.

Schools must lead this change, stressing the value of Reputation and leadership over shared values. The times of imposed values and authoritarian decisions are at an end. This transforming leadership requires other skills and abilities going beyond mere specialisation in finance or marketing. Returning to Mintzberg, when faced with the age of chaos and uncertainty, executives must take on different roles (monitor, propagator, representative or negotiator, among others) to "establish a certain degree of order in the chaos the naturally reigns in organisations". We need business schools to break again the trend of classical study of management.

This is no mean feat: it is up to business schools to help recover the trust and prestige of the business world. As long as society continues to distrust companies, schools will find it harder to enrol students and good lecturers. For this reason, business schools have a responsibility to take part in the transforming leadership of society.

We are faced with at least three challenges.

In the medium term business schools will transform into service companies, whose main product —the MBA in any of its formats— becomes the starting point for a more complete offer. XXI-century executives cannot settle for an advanced course after finishing their degrees, they must be in continuous training.

The service orientation consists of creating value through the alumni networks, improving the offer of corporate services and developing a large array of continuous training, in-company or in open formats, establishing alliances with leading companies in their respective sectors or creating educational content adapted to mobiles and tablets.

In short, through continuous education supplemented with sophisticated services, schools must make a real impact on the transforming leadership processes experienced by individuals and enterprises in this society of change.

Just as in other economic service activities, it seems even more necessary to contemplate alliances, mergers or stable arrangements with other schools throughout the world to create global networks.

If the new executive is to understand complexity and globalisation, he must travel and see and try out different business solutions and methodologies.

The monopoly of the case method is doomed to end, just as we have witnessed the end of magisterial lectures.

"The new paradigms of the Society of Change in the world of business, executive management and value generation in companies and financial institutions, through and around Reputation, require new styles of Leadership based on Corporate Diplomacy"

It will be necessary to learn through practice, projects or real cases. Different schools are already clinching agreements with non-governmental organisations so that the leaders of the future learn and start out in a real context, rather than in cases written in Boston.

The development of methodologies such as *gamification* or others we do not even imagine today will be consolidated. Training becomes an experience, increased by overlapping it with practical training, apparently far-removed from traditional management, as has already occurred with sport, design or gastronomy.

In particular, the commitment to entrepreneurship will be important.

It is not a fashion, but the necessary answer in Europe to search for new deposits of employment. Here schools have a chance to become knowledge hubs —global, geographic, specialised or under whatever other criteria— aggregating value through meetings with investors, lecturers, students and other entrepreneurs. These usage clubs are once again strategic, because they generate a social network of work, employment and exchanging of experience.

In short, the range of executive skills and competence introduced in the executive map will be broadened. The strategic dimension (vision and mission, business, management of people, creation of networks) will naturally be at the heart of training, while new personal dimensions will be included (stress management, ambition, capacity to channel initiative) along with inter-personal qualities (charisma, team work, communication and oral presentation, handling of conflicts). All against a backdrop of permanent change.

7. CONCLUSION

The new paradigms of the **Society of Change** in the world of business, executive management and value generation in companies and financial institutions, through and around Reputation, require new styles of **Leadership** based on **Corporate Diplomacy**.

Business Schools are required to play a decisive role in the transmutation of the *little bosses* of the XX century into real **Corporate Leaders** of the XXI century.

The "Great Recession", which has been penalising many of the traditionally most prosperous economies in the world for over five years now, should teach us a few lessons which can be applied in the future. To make changes. This would be one of the few positive after-effects of a period that has caused and is still causing so much damage.

The market economy must obviously move towards new proposals, eradicating others that

"The alternative is a new social economy and a new entrepreneurial class with profitable, sustainable projects based on solid values"

have proved perverse. The idea of the social enterprise, with a much more humanistic dimension, emerges from this setting.

Companies seeking the "fivefold result", guided by the "Five P & L Account": developing simultaneously in the dimensions of economic profit, governance and ethics, protection of the environment, conserving talent and looking after employees within organisations and any others forming part of their value chain and society.

Let's hope we are able, from this old Europe now called into question, to define an attractive story —*storytelling*— and conduct —*storydoing*— around a new way of doing business.

To achieve this, we stress, business schools have a responsibility and an important role to play.

This European project that has given us the longest period of peace and prosperity in our history, plagued with fratricidal battles between those of us who form part of the United Europe, is now thirsty for storytelling and storydoing.

The European discourse cannot be limited to just conjugating the verb adjust while nobody appears to take responsibility for what has happened.

The alternative is a new social economy and a new entrepreneurial class with profitable, sustainable projects based on solid values. The option of the "Five P & L Account" should be raised up against the "triple crisis".

In this context, Reputation and Corporate Diplomacy take on a renewed validity in the leader profile of the society of change[27].

27 The authors acknowledge and express their gratitude for the work done by Beatriz Herranz, LLORENTE & CUENCA, editing and checking the data of this essay.

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