

Tomorrow's Finance

Finance as a Force for Good

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by Katherine Garrett-Cox



Tomorrow's Company in partnership with Miton Group plc



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Katherine was nominated a Young Global Leader of the World Economic Forum in 2005 and was awarded a CBE in the 2014 New Year Honours List for services to the Asset Management Industry and charitable service through the Baring Foundation.

Finance as a force for good. Well is it? It rather depends upon how you define good. Is it simply organisational good through increased profits, gainful employment and self-gratification, or is it to do well as a business whilst also benefiting society? Do these factors have to be mutually exclusive? Personally I don't think they have to be. Good as I see it, is about building a resilient business, being relevant for future generations and having a culture that is strongly anchored upon a sense of responsibility towards others. Certainly that is our goal at Alliance Trust.

We are a case study in resilience. Throughout our 126 year history we have exhibited these characteristics, if the hallmark of success is longevity – then my predecessors certainly anchored a duty of care into the heart of our company. They have successfully protected our shareholder's capital from the ravages of war, depressions, recessions and inflation, when many others have failed. We have constantly adapted. From our early days of providing mortgages, to investing in land, railway bonds, fixed income and equities, to our renewed focus on growth through our savings platform and responsible investment business, we have been flexible.

We have recognised our broader responsibilities to society at critical points in history. Whether in the late nineteenth century by helping individuals as a mortgage lender, through our involvement with the Treasury in 1942 when our directors were heavily involved in the effort to liquidate requisitioned British assets in the US during WW2 and now more recently through our investments – where we understand and measure their impact upon global communities.

Despite the passage of time, there is still no other trust with our structure, and it is as a result of the skill and foresight of those that have managed the Trust over many decades, that we are so well placed to face the challenges of the 21st century and to continue in our aim to be a force for good, investing for generations, on behalf of generations.

Nearly three years ago, we began to see the “sense in sustainability”. We have always championed transparency and a low cost approach. However we saw an opportunity to pioneer the true benefits of being a good global citizen. We believe we have unique credibility both as a PLC as well as a global investor. We recruited a team of fund managers, who now manage our range of Sustainable Future Funds alongside our core global equity and fixed income teams. At the time, some people thought we were mad. Now, we are one of the top 5 SRI investors in Europe and much good has come of it as we have won assets and recognition for our efforts. But what I've come to realise is that this was just the first step. Our quest is far from over.

Financial services can and do make a huge difference to society at large. We often don't get credit for that, indeed not everyone thinks that finance is a force for good.

But I do. And I think it will be a far greater force for good in the future – but only if we have courageous leaders who lead by example and embrace their true responsibilities. In the words of Michael Josephson, “We can't live forever, but what we do can change lives forever”.

The importance of financial services to the UK economy is often underestimated. London is a global financial centre, indeed the second largest financial centre in the world, a leading exporter of financial services, and a magnet for world class talent. The City is good at being relevant. We have the fourth largest banking sector after China, the US and Japan. This is important, as a vibrant and thriving financial sector keeps societies' wheels turning.

There are many benefits that this sector brings to the economy, contributing £174bn or 13% to our GDP. Moreover, a fact that is often overlooked is the scale of tax that is generated from this part of the economy. This accounted for £65bn in tax revenue between 2012/13.

It has a human dimension. The size and growth of financial and related professional services plays a crucial role for the UK labour market. Around 2 million people or 7% of the population work in these sectors. It's not concentrated here in London as many might assume. In fact, two-thirds of people in the sector actually work outside London. This industry has given the UK economy an important boost at a time when it was much needed.

But it's not all rosy today.

Without doubt, finance has suffered reputational damage in recent years, a fact that has tarnished the City's status as one of the world's leading financial centres. It's rather depressing, to say the least. Trust takes years to build and seconds to destroy. Scandals such as Libor, foreign exchange fixing and misselling cases, have reinforced the view that financial services businesses are sometimes self-serving and disconnected from the real world. In truth we have lost a sense of responsibility to others.

Mark Carney, the governor of the Bank of England, has told us that "If organised properly, a vibrant financial sector brings substantial benefits. The UK's financial sector can be both a global good and a national asset." We're all proud of the national asset the City of London represents. But remember Carney's condition: "*If organised properly...*"

For nearly 100 years, not much has changed in financial institutions:

- We still value businesses with many of the same metrics we used 100 years ago – through short-term performance and strength of balance sheet
- We design complex products which are about making profit for the finance sector rather than what customers in the real economy need
- We hire in our own image which has resulted in an alarming lack of diversity
- We build complex reward structures for ourselves which are often at odds with the value created for shareholders or society
- We stifle innovation which has resulted in a lack of renewal within our organisations.

Indeed, innovation in finance – *real* innovation that leads to new products and services for the *real* economy – is lacking today. We need to reinvigorate innovation and encourage new thinking. Innovation should be the beating heart of any company; it keeps you relevant, keeps you strong and keeps you competitive.

It's rather depressing that innovation has become a dirty word when associated with financial services. What if the creative thinking behind CDOs was turned towards products that benefited society? Let's face it, our past innovations, such as PPI and guaranteed products have not always been a force for good.

We've all been tarred, as a consequence. Think of university graduates. Some no longer want to work in the City and those who do, want to leave with their souls intact. The next generation is fed up with companies that don't get the balance right between profit and purpose. Younger generations want to work for companies which are a force for good.

I witnessed this first hand when I visited the graduating MBA class last year at INSEAD. I asked them what their main priority was as they returned to the corporate worlds. For them their focus was not materialistic, it was a common desire to ensure that the company they work for shared their own vision and values. This is what the next generation wants so if you want to be a magnet for talent, you need to get this right.

To remake ourselves for the future, to redress the damage that has been done, to rebuild the trust we have lost, to be a part of the solution to the challenges we face as a society – is going to take nothing short of revolutionary change in our sector.

We can't wait for regulation to change behaviours; we must change ourselves, to instil the right culture and values within our businesses now. Leaders need to lead the way towards true north and set the moral compass our organisations so desperately require. In essence, create a binding commitment to doing the right thing.

Values haven't always been something the financial sector has talked about. But all organisations – including our own – are part of society, so we need to ensure that our values are aligned and that our actions live up to them.

It starts with simple things. It's deeply frustrating that many institutional investors shirk their duty to vote at AGMs. They come up with lots of excuses – too busy, not enough resources. But the bottom line is that they have a clear responsibility to their clients and they need to take their stewardship responsibilities more seriously. We do.

Equally companies must engage with their owners – especially retail investors who often feel far removed from the boardroom. We have been delighted since we launched our "Investment Focus Hub". (<http://www.investment-focus.co.uk/>) – and attracted over 52k unique visitors within the first few weeks.

I certainly acknowledge the difficulty of the trade-off between short-term and long-term. For decades the business world has measured success through short-term profits, not long-term mission. CEOs are often chained to quarterly reporting and this drives short-term planning and thinking. We support Professor John Kay's paper on the UK Equity market review – and endorse moves away from excessive short-term reporting. The role of the media in achieving this should not be overestimated – 'breaking news' pays too little regard to longer term strategy.

Getting the balance right between delivering short-term profits, building value over the long-term and contributing positively to society, is crucially important for the City today. If only the dialogue could evolve away from a singular focus on short-term incentives to one where investors give credit to CEO's for focusing on the long-term, we would surely be serving society better.

We exist to serve. At Alliance Trust our strategy, called Investing for Generations, will take our business through 2020 and beyond. Our mission is to become the UK's most trusted investment and savings business. We don't yet know all the answers and our strategy will surely evolve over time, but it has been very liberating to talk about long-term goals. It is evolution, not revolution. It's about long-term capital growth for our shareholders, with rising dividends – a feat that we have managed every year since the mid 1960's. We have an inspiring common roadmap for our people to see and importantly, be part of. Supported by strong values, we are building a more sustainable company and competitive advantage.

We *know* that we can create value for shareholders *and* for society. But will society value our efforts? I believe investor and consumer mindsets are shifting – albeit in a patchy way. In fact, as we began to communicate about our sustainability goals and 2020 strategy I received a few letters from shareholders wondering why we were wasting our time and effort on such issues, and shouldn't we be more concerned about performance and profits. Believe me, we are. It's just that we see performance and profits as an *outcome* of these additional efforts.

Alliance Trust is building a business that is *resilient* for the long-term, continuously *relevant* to customers whilst possessing a strong moral compass and a sense of *responsibility* towards society. Our business was formed 126 years ago by some very forward thinking businessmen from Dundee, including Robert Fleming of the Fleming's dynasty, but remains as relevant now to its shareholders as it was then. We express our purpose through two common goals: To deliver a sustainable financial future for our shareholders, customers and people, and to make a broader contribution to society and the communities in which we operate.

In order to deliver on these goals we have put in place some simple steps and actions which will drive our success, starting with a journey to develop the right culture. A culture which encourages tolerance and inclusion for all, which welcomes diverse viewpoints and experiences and which encourages challenge to the status quo. The culture we are nurturing will always point true north; will always do the right thing by customers. We are open and transparent in everything we do and set clear and measurable long-term targets for ourselves. We are prepared to be held accountable.

Our Investing for Generations strategy will build our business and build prosperity for all our stakeholders. We use it to play an active role in the community and take our responsibilities seriously. Dundee may be well known for “jam, jute and journalism”, but it is also Scotland's second poorest city. Our activities include supporting the local riding school for the disabled, and Scottish Opera who are running drama workshops for dementia sufferers and their carers. We have collaborated with social enterprises to support financial education in schools, and have helped close to 300 school leavers in Dundee with career advice and planning. I am particularly proud of our 4 year collaboration with the Soldiers' Charity through the Alliance Trust Cateran Yomp – a 54 mile walk taking place this weekend in Scotland. Many of the home team are walking, supporting and volunteering to raise money for the charity and our own Staff Foundation which supports a myriad of local organisations.

We actively promote volunteering and encourage everyone to think about those less fortunate than ourselves. We support the local food bank, which ran perilously close to the wire before Christmas. It's a genuine team effort. All of these measures have helped create intense loyalty and a unified culture.

Critically, we don't do this "on the side". We embed it into the heart and soul of our organisation – and have a strong sense of purpose.

But can we also impact the heart and soul of the financial services sector? We believe so.

Asset management businesses invest in global companies, so we have a far reaching impact – we have a critical role to play in engaging and working with businesses around the world. We can offer constructive challenge and have a robust dialogue when we see issues arise. We can encourage ethical business practices and take action when basic human rights are impacted.

Alliance Trust played an important role following the collapse of the Rana Plaza factory in Bangladesh. We worked closely with others to champion the Bangladesh Accord on Fire and Building safety, enlisting support from shareholders representing more than \$1tn of assets. We are working with NGO's such as Global Witness to engage with companies to stamp out illegal and corrupt business practices. As an example, too frequently, banks inadvertently accept funds that have been stolen by the state by corrupt officials – mainly due to inadequate anti-money laundering checks and poor systems. Of greater concern is the sheer scale of the abuse of "phantom firms" – hiding the movement of those same stolen state assets. A World Bank study of corruption cases over a 30 year period showed that 70% of them used companies to hide their deceit. The recent events in Ukraine, a country where the average salary is less than £300 per month was in part caused by systemic corruption. The Presidential 140 hectare palace, outside Kiev, a tangible symbol of such activity – was part owned by a British company. Clearly, we need to care more about the transactions we facilitate, about how the capital we allocate is used and how we hold people to account. We might be small in relative terms, but we have a big voice.

We have both the need and the opportunity to work alongside others, to collaborate often with surprising partners, to lead in the field of responsible investment. From our early beginnings we have seen the benefits of such a strategy. Our investment team were early signatories to the UN PRI – the investor counterpart to the UN Global Compact and we are chairing their work on integrated ESG factors into company analysis. We collaborated with Scottish Wildlife Trust to support the first ever Forum for Natural Capital and are now actively involved with the World Business Council for Sustainable Development in a pilot programme to create a common set of valuation principles which account for this much misunderstood topic.

I've spoken about the need for innovation. One way for the City to innovate is to lead the way in redefining how we value natural capital. I had a fairly sobering discussion with global business leaders on this subject back in January. Half of them looked blankly at me and had no clue why it was relevant to them or their companies. For us it represents the nexus between people/planet and purpose.

Natural capital is defined as the world's stocks of natural assets including geology, soil, air, water and all living things. From this natural capital we derive a wide range of services, often called ecosystem services, which make human life possible. In a world heading towards 9 billion people, our resources are finite.

How to value and manage natural capital is a complex problem, still subject to debate. Whilst many companies are tackling issues which directly confront their businesses, such as water and biodiversity, natural capital accounting is a significant issue that requires more coordinated work between companies, governments and NGOs.

We see the potential for the finance sector to help identify and ultimately value the contribution that natural ecosystems make to our businesses, economies and society. For the good of our children and grandchildren, we want to pioneer for the future in raising awareness of this subject, just as we have been pioneers in the past.

We wish to shine a light on the 'economic invisibility of nature'. It's a move away from quarterly earnings reports, away from 'sustainability screens'. It's a move towards *integrated valuation models* which place higher value on businesses with better integrated performance on their combined financial, natural and social capital. If our analysts pay attention to social and environmental externalities, all businesses will follow that path. It's this kind of sustainable solution that will make finance a force for good.

Mark Carney challenged us to do "global good", and the UK is leading the way. Banks are dealing with the problem by tightening their anti-money laundering rules and by improving checks and systems. They are also ensuring the right culture is in place, with appropriate and effective board oversight. In addition, the Prime Minister used his chairmanship of the G8 to extract promises from other countries in proposing legislation that will put the beneficial owners of UK incorporated companies on the public record, a commitment that was reaffirmed in the Queen's Speech recently. Investors can play an equally important role by holding companies to account in terms of the people they do business with – ultimately it reduces major legal and reputational risks and almost certainly costs.

It is clear that the finance sector is beginning to wake up to the required changes. Certain organisations are being shaken up by forward thinking CEOs who are determined to bring about long-term sustainable growth for their businesses, their shareholders and for society as a whole by working on practical solutions to global challenges.

Every CEO has a duty of care – a duty to leave their company in better shape at the end of their tenure. My nine predecessors believed in this too. To do this, an integrated and responsible strategy is a necessity, not a choice. One of my colleagues coined a phrase at Alliance Trust that "if you choose to act against society, then eventually society will act against you".

Our Investing for Generations strategy has given Alliance Trust a renewed purpose, a soul, and in many respects we have gone back to basics – 126 years ago we helped settlers in the Midwest of America fund mortgages to build farming communities and support future generations. We are still investing on behalf of many generations, but now we have a global reach through the companies in which we invest and strong global partnerships across business, government and NGO's. We are determined to make a wider contribution to society so that all may prosper.

Our guiding principles at Alliance Trust are resilience, relevance and responsibility. I hope that our words and deeds will encourage others to think about combining profit and purpose to create a stronger and more long lasting financial services sector, trusted by society at large. This is a moment for leaders, like you, to be bold, authentic and brave. You can make a difference.

I have worked in financial services for nearly 25 years and have never felt such intensity or clarity of purpose. I am proud of the journey so far and inspired by the journey ahead.

We represent a very privileged industry, so even more important to use the opportunity to create something better. I close with a quote from Winston Churchill, probably Dundee's most famous MP, who remarked that "The price of greatness is responsibility".

The City of London has surely achieved greatness. Make sure you help the City live up to its responsibility.

About Miton

Miton is a leading multi-asset and equity fund management specialist. The group manages £1.8bn of assets including nine OEICs, three investment trusts and segregated client accounts. Members of the fund management team invest in their own funds and are significant shareholders in the company. Miton has offices in Reading, Liverpool and London.

www.mitongroup.com

About Slow Finance

Slow Finance by Gervais Williams focusses on the types of businesses that banks and other financial institutions should finance, the criteria they should adopt and above all the nature of the relationships which can best secure long-term returns – such as exploring in depth financing for food production and other areas vital for economic prosperity and future wellbeing.

To order the book and use the app: www.slowfinance.com

About Tomorrow's Company

Tomorrow's Company is shaping the future of business success to build lasting value.

We are a London based global think tank delivering value for business leaders and owners by addressing the systemic and behavioural questions of the business world. We defined the inclusive duties of directors for the UK's Companies Act 2006; our work on financial markets informed the creation of the UN PRI; our thought leadership is at the heart of the UK Stewardship Code and of the integrated reporting movement; King III in South Africa acknowledges our influence. We believe businesses can and should be a force for good. We inspire generations of business leaders to shape the way they do business. Our work today will restore the licence for business to operate and for businesses to be successful tomorrow.

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