



**Sustainable Prosperity -  
Confronting the Inconvenient Truths**

**Trans Tasman Business Circle  
28 June 2006**

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## **Sustainable Prosperity - Confronting the Inconvenient Truths**

Today I want to talk about how we have built a more resilient and sustainable Westpac. And I want to talk about some of things looming in the corporate world; things that we can ignore or pretend are not there. How we respond is optional - but only for now. Sooner or later the reality will have to be faced.

In particular I want to look at the challenge of sustainable prosperity. This I'd suggest is the biggest challenge and the one that by rights should unite us all.

I also want to try to move the debate beyond the present narrow focus on corporate responsibility.

Corporate responsibility is a concept that is widely misunderstood and hence sometimes divisive. Too often it is taken to mean something quite separate from the normal course of business. And wherever it is seen as an externally imposed obligation, the division between value for shareholders and value for broader stakeholders is confirmed. Yet this division is essentially meaningless.

The way ahead, I believe, is for corporations to adopt a form of rational, self-interested business behaviour that looks beyond a narrow focus on shareholders and short-term profits to something more enlightened. Something we might call 'enlightened shareholder value'.

When I took over as Westpac's CEO, our business did not totally run this way. Some of our business practices were out of kilter with the expectations of our staff, our customers, and the broader community. Shareholder value was not being optimized – not immediately and not over the longer term.

We decided to take a new way. It would be built on strong principles: with our reputation and social license to operate at centre stage. We started out by laying down the principles. And as it turned out, these principles came to be the heart of what is now often termed corporate responsibility and sustainability.

From the principles we composed a three-point strategy – to manage long, to manage broad and to manage ethically.

Long, because by resisting the attractions of the short-term and market demands to maximize near term value, we'd maximise our future value and resilience.

Broad, because by taking account of stakeholders who were not share owners, we'd be attending to people who have a fundamental impact on our risk, resilience and revenue.

Ethically, because values, uniformly observed and understood, inform, guide and motivate our organization and our people to act in responsible, ethical and trustworthy ways.

Let me take you through the rationale, and remind you that at the time a lot of people did not see it as rational at all.

They reckoned that if it was not addressed to the virtual exclusive interests of shareholders it could not be rational. We hear much less from them these days.

The logic of managing long is straightforward, especially once you've recognised that in essence point-of-time measures of a company's value simply represent the discounted value

of expected future cash earnings. Given that longer-term cash-flows clearly matter in this regard, it seemed logical to manage the company with this in mind.

Added to this, I inherited the leadership of a 182 year old company – Australia's first company. Next year we turn 190, a rare thing in an age when the average company stays in the S&P 500 turnover list for only ten years – and the average CEO lasts less than five!

Westpac's remarkable place in Australia's history was further encouragement to buck the short term trend. And buck short-termism we have – resisting giving specific short-term earnings guidance and standing out against the latest fads.

The logic of managing broad really comes from rediscovering the idea of the corporation itself. Today, corporations are generally viewed to be just a legal idea. But lift the veil and we see the real dimensions: the economic engine that they constitute, and the social system of shareholders, employees and customers.

When we talk about meeting the needs of the corporation, we are really talking about meeting the needs of both the economic machine and the social system that is inseparable from it.

That is why managing broad, in the interests of our people and our customers and contributing to community building, is so vitally important. In our case, this is at the very core of our 'service-profit chain' business model, which links engaged employees to satisfied customers to value adding outcomes for shareholders.

This is where we meet the logic of managing ethically. Being a social system that is part of the larger society creates an imperative to operate our business in line with societal expectations – to operate our business in a responsible, ethical and trustworthy manner. And being so pervasive, meeting our own needs as a business simply merges into meeting the needs of the community.

Just as critically, our employees do not leave their own values at the door when they come to work. On the contrary, they want to work for a company with a decent set of values - values that align with their own. It is a fallacy to think that you can micro-manage individuals and determine the way they think, especially our younger generation.

Strong corporate values are the glue that knits together the companies social system and the economic machine.

This plan of ours was strategic. Strategic in terms of:

- Managing our regulatory and reputational risk - managing our social contract if you like;
- Capturing value-creating opportunities by understanding the emerging socio-political environment and trends better than others; and
- Driving value through meeting the broader needs of our people and our customers.

This set us on a new path - implicitly seeing sustainable shareholder value not just as an end in itself, but also as a measure of how successfully we deliver value to society and ensure ongoing prosperity.

Sustainability and prosperity are concepts that have always fitted well with Westpac. Older than Australian democracy; older in fact than all but two of the Australian colonies; and born just two years after the battle of Waterloo, Westpac represents a central and unbroken thread in Australian history. It's a company that has learnt through long experience to create wealth, fulfil ambitions, provide security, and to contribute to the building of community and nation.

But before expanding on sustainable prosperity and the role of business, I want to briefly dwell on three somewhat inconvenient or uncomfortable facts – facts that do not always sit well with our purposes and needs.

First, it appears that while humanity has the resources to address the world's most pressing needs, the world itself has yet to fully accept the immensity of the challenges. To name a few, the need to:

- Reduce greenhouse gas emissions;
- Stop water tables falling;
- Halt the worrying growth in trans-national organised crime and terrorism; and
- Provide safe and abundant energy.

Second, there has been a dramatic and unprecedented shift in economic power, from the public to the private sector, over recent decades, and the shift continues. Corporations now make up more than half of the world's 100 largest economic entities – nation states are in the minority.

Third, trust in big corporations is at an all time low and cynicism at an all time high. Business is typically perceived as self-interested, uncaring, and prone to – if not poisoned by - hubris.

This leads me to two conclusions:

- We had better start doing something about these problems that threaten the sustainable health of the planet and the system as we know it; and
- Business has to be a key part of the solution.

In this endeavour it will help to remember that business can only sustain and prosper when the world sustains and prospers. Which takes me back to what I call sustainable prosperity.

In all developed countries, including Australia, society has become much more pluralist; made up of multiple institutions and groups, each to varying degrees pursuing their own agendas and goals. It is a system that to date has served us well. A system that has performed.

But as Peter Drucker, the greatest management thinker of our time, reminded us, all earlier pluralist societies ultimately destroyed themselves because they failed to keep sight of the common good – failed to keep sight of the broader community needs. It's a sobering thought.

Closer to home, the idea of a society built on trust and fair play is familiar to all of us. Most business men and women recognise that prosperous high streets need prosperous back streets.

But for too many of us in business it seems to stop there – crowded out by the noise of today and of the business itself. Somewhere lost in the noise is any real engagement around the kind of society we want - the kind we need to underwrite those prosperous high streets. Only underneath the noise, in those rare moments of true reflection, do we get a clear picture of what we want:

- A society free from crime and one where we can walk the streets.
- A truly civil society that safeguards liberty and creates opportunity.
- A society where the unacceptable disparities in opportunity, education and healthcare are reined in.

To capture and maintain these societal ideals, we need to challenge some basic assumptions that are often taken for granted.

To take just one of these - the assumption that what we do at present does not really threaten the carrying capacity of our planet - the facts are that:

- The world's population in 1950 was 2.5 billion – today it is over 6.5 billion, and is projected to be over 9 billion by 2050.
- The current absorption capacity of carbon by the oceans and forests is about 3.5 billion tons per year - yet we are currently adding twice that amount to the atmosphere each year. And as population grows...you can make the calculations.
- And, according to the millennium ecosystem assessment, 60% of the world's vital ecosystems are currently being seriously degraded or used unsustainably.

Closer to home, if we don't change our ways soon, within this century we run a real risk, due to rising temperatures, of losing the vast majority of the great barrier reef to bleaching; losing 80% of the Kakadu wetlands; and experiencing a doubling of the flooded areas along our coastal seaboard.

It's a picture that no thinking person should be complacent about. Uncontrolled consumption of scarce natural resources, growing greenhouse emissions, and the resultant climatic impacts are things we all should find unacceptable. The science debate is largely over – it's been won, in the minds of most rational people. All governments that matter, including the G8 and China and India via the Asia-Pacific partnership on clean development and climate, are on board and now agree that the need for action is here and now.

As the council of Australian governments has said, 'early action by all nations is needed to make the task of stabilising and then reducing the level of greenhouse gas emissions in the atmosphere less costly to achieve'.

But then the politics, the rhetoric and the short-term take over. And I don't blame only governments for this. Governments can only do so much. Business, big business, holds many of the keys to solving the problem. Business has the know-how, the innovation, and the financial wherewithal to provide the necessary leadership and action. And business has the most to gain, or to lose, depending on how you look at the issue.

Yes we need government action, and urgently. But government is the agent of the people and of business. We need to create the conditions, the climate, for government to get the right framework in place so that market mechanisms can operate with the appropriate pricing signals - and so that investments in low carbon technologies and energy sources can flow.

I for one don't wish to see our tourism industry and much of our agriculture sector being used like canaries in the coal mines to ultimately tell us we have a problem.

Particularly as we have the means to achieve the 60% reduction in greenhouse gas emissions that is required by 2050 to eventually stabilise the concentration of CO<sub>2</sub> in the atmosphere. But we have to act and we have to act now.

That is why the work of the business roundtable on climate change is so important. The roundtable showed that achieving such a reduction was possible while maintaining strong economic growth. It also showed that delaying action will have a significant negative economic impact, with the risk of a major disruptive shock.

The government's nuclear energy inquiry now provides an ideal opportunity to get the vexed issue of putting a price on carbon fully out into the open. The inquiry will bring to the forefront the business roundtable's contention that we need a clear market-based carbon pricing signal, so that our investment decisions on clean energy reflect the real economics and costs.

With the right pricing signals, the market will find the cheapest way to achieve the needed reductions in greenhouse gas emissions.

The choice between sustainability and prosperity is yesterday's choice, a false choice. There is no choice but to get on with the task of securing both sustainably.

I could ask how many of you have property insurance. I could ask you why. Or how many have lost their house or business premises to a natural disaster.

The question is, why we sensibly take on precautions against such risks, but when it comes to the future of the world we are prepared to sit on the fence and wear the risk. The smoke of a bushfire alerts us to danger and causes us to act. We do not assume that someone else will put it out, or that the wind will blow it on to our neighbour's or competitor's property. We know we have to act.

By now we have all seen the smoke. It has been identified as smoke. And as surely as with the bushfire, we know we have to act.

It is nonsense for anyone to continue to protest that the business of business is simply business - in clear denial of these inconvenient truths.

These are not just someone else's problems. It is in our interests to respond; we have an obligation to do so. This is pragmatic and undeniable. The idea of narrow corporate self-interest won't cut it anymore.

Society, via our legislature, has placed great trust in corporations to use their expanded power responsibly and in the interests of the community as a whole. When that trust is betrayed, as with Enron, WorldCom, HIH and so on, the community is quite right to wind back such trust through new regulation and requirements.

To avoid traveling down that less creative, less dynamic, and less sustainable path, business needs to re-embrace the original concept of capitalism. Adam Smith underpinned his 'capitalist' system with the virtues of justice, fairness and honesty. Smith saw neither selfishness nor greed as virtues and regarded the spheres of human conduct - economic, social, moral, and political - as interwoven and mutually dependent. We need to constantly remind ourselves of this.

What's more, the blue-print for capital and value creation, economically, socially and environmentally through responsible business practices is now well established at both the strategic and operational levels. And the role and responsibilities of directors in all of this have been actively debated, as have the value of non-financial reporting, and the concept of intangible value. But adapting traditional performance metrics to pick up these non-financial dimensions remains a challenge.

Let me set out the problem. The financial accounting system has served us well; but the system still struggles to fully capture and describe the value within modern businesses.

In Westpac's case, for example, fully 70% of the value assigned to Westpac by the market is not captured in the traditional financial measures. Employee commitment, occupational health and safety, workplace diversity, governance and leadership, customer satisfaction, product and service quality, brand strength, environmental impacts, the quality of relationships with stakeholders, and so on, are all critical to our longevity. But they currently have no place on a traditional P&L and balance sheet.

As long term indicators, the annual P&L and balance sheet reports are problematic because they are seriously incomplete in regard to business sustainability. They are at best benchmark report cards on the journey, and don't capture our overall purpose. That's why it's so important to move beyond the narrow financials and measure, manage and report on these critical aspects of our business performance.

In our case we're not a products company; we're a human company satisfying customer needs. It's the discretionary effort of our people and how they behave that holds the key to our strategic success. This is why I've talked a lot about our corporate DNA in the past. And it is why we are now focused on unpicking our corporate genome to better understand the many links between these non-financial drivers and financial outcomes, and making sure that we measure what matters most. After all, the bottom line is just that - downstream of the countless drivers that contribute to the P&L.

I don't expect any resolution to this dilemma in the short term. It is very much a work in progress.

So let me finish with a call to action.

As businesses we need to provide a new form of leadership - 'enlightened shareholder value' leadership that goes beyond the walls of our corporations and uses our increased economic power responsibly.

We need to manage broad, long and ethically. There is no question that companies can do good and do well at the same time. It's been the formulae for our success.

Irrespective, there is no question that one way or another, the community's needs will be met: they can be met by corporations doing the right thing, or through governments taking legislative steps in response to corporate denial, ducking and weaving. For all of us in business there is only the future. Today is the future.

The only constant is change, and the necessity to anticipate and adapt to it to preserve the future. This is why the idea conceived in a penal settlement at the bottom of the world nearly two centuries ago is as relevant as ever. The idea was to create security and wealth through economic activity and through it to build community and sustainable prosperity. It was the idea for a bank.

It is still the idea at the heart of Westpac – the core idea, the sustaining one. And one that has particular relevance well beyond Westpac to the global challenges we face today.

Thank you.