Business relationships – do they count anymore?

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Introduction

This lecture is my second designed to address some of key issues which have dominated my business and professional career. It concerns a very basic aspect of business, the relationship between individuals and business entities, with some common interest or objective. I define relationship as the development over time of mutual interests, understanding and trust, so that each party to it benefits from it and wishes to continue it. It is a continuous and two way stream, based on the past and looking to the future; it cannot survive if either party does not desire that it should do so. The relationship may involve a business transaction in the form of goods and services between corporates, or it may involve the provision of labour, as between employer or employer, or it may involve a subtler, but nonetheless important relationship, as with shareholders or between regulator and regulated, or between representatives of the communities or the environment within which a corporate operates, as examples of the other stakeholders in a business.

Board's strategic role in relationships

It is obvious that the overall topic of relationships is complex, many sided, and as broad as it is long. I thought therefore to take the perspective of the Board in determining the key aspects of relationships, and the extent to which boards should consider, as part of their regular deliberations, the requirement for, quality and depth of relationships. Relationships in business are in general regular, continuous affairs, conducted very much at an operating level, so that th'ey are for the most part well below the Board radar. There is however a very important aspect of every business relationship on which I shall focus: the concept of the investment in those relationships - and it can be costly in terms of time, cost and materiel - in relationship as an insurance premium against some strategic event, circumstance or change, where the quality of the relationship becomes critical, and if substandard potentially very costly - a premium against risk. The board's role then is to ensure that this so-called premium is being paid, and regularly to consider this as part of the risk analysis and compilation of the risk register, that is now a normal and important part of corporate governance. I shall concentrate on supplier relationships in the particular context of the banker-customer relationship, on that between employee and employers and with the key stakeholders of shareholders and regulators, very much with a City flavour.

Relationship as insurance

This insurance aspect of relationships is often down played or overlooked. Take as an example commoditised transactions, which are often put forward as circumstances where relationships simply are not worth establishing - they are supposedly too costly, and the product can be bought from a large number of purveyors, the name of the game being shopping around. But look at commodity transactions themselves, inside or outside formal markets. Classically commodity market users will deal through a wholesaler, broker or middleman, who will depend on the former to deliver either cash or the relevant commodity, to be as good as his word. In other words, the wholesaler has a delivery or cash risk, often called 'counterparty risk', and will therefore maintain a line or limit of his exposure to the customer, which will be designed to cover a significant number of transactions, and beyond which he will not be prepared to go. It will be based on the customer's creditworthiness and the wholesaler's perception and experience of the reliability of the customer.

Some users will use their perceived attractiveness in such markets to try to finesse the need for the establishment of a relationship. Their attraction is so great, they believe, that those with whom they deal will always deal with them, regardless. And under most circumstances this may be true. But there may occasionally be times when it may not be so easy for them. In the case of commodity markets, there are two important examples: first, where the counterparty risk increases - the customer is going through a tough time commercially and financially affecting his creditworthiness and even his long term viability in that market - or where there is a shortage or glut of the commodity for whatever reason, and this creates difficulties for the would be buyer or seller, certainly in the absence of a strong relationship. But where there is a strong relationship the counterparty may be happy to manage a deteriorating credit and delivery risk based on knowledge, confidence and the potential for future business when the trading crisis is over for his customer. If the counterparty is a seller in times of shortage he may be inclined to ration his sales to those customers with whom he has a quality relationship; and, if a buyer, he may be prepared to deal with a distressed seller for the sake of the past and more business in the future.

The conclusion is that the establishment of a relationship, costly as it may be to set up and maintain and however commoditised the underlying product or service, represents a form of insurance premium against a change in circumstances, which may even in some cases be life threatening. The Board's role is to ensure that the nature of the risk is appreciated and that the premium is properly paid, fine print and all.

Of course the one uninsurable risk is the random behaviour of individuals in relationship building. I have spent some time in and around the advertising business, where of courses pitching to gain and keep accounts is the order of the day. Everybody involved in pitches is literally on their best behaviour, before, after and during. When I lived in Sydney, there was a famous story of how one target customer could only arrange the relevant pitch at 9am on Saturday, not a hugely popular gesture, having regard to Aussie Friday night habits. One dishevelled member of the pitching team travelled up in the lift at 8.59 that morning, and was asked by the other person in the lift (whom he didn't know) how he was - 'Goodaymateowyergoing?' or words to that effect. Reply: 'Bloody terrible, mate; mouth like a Chinese wrestler's jockstrap, and some guy wants us to tell him how to sell his lousy product at this time of the morning. Don't know who's worse - him or the soap powder'. No prizes for guessing who the client was or what was the outcome of the pitch…

People

One of the more fascinating aspects of business is that, although huge amounts of money and other resource are expended on the image, clubability, quality and reputation of the corporate entity - a very simple example is the building up and investment in a brand – so much of the quality of the relationship depends on the individual, particularly when the individual's skills can be separated from general perceptions of skills, trust etc attributed to the firm. In fact corporate relationships are a complex mixture between people acting on behalf of their employers and of the employer itself.

The human facts are that most people set out to enjoy their business life where they can, and one of the pleasures is to do business or relate to people whose company one enjoys, whose abilities one respects, and, perhaps most importantly whom one trusts. People are if you like the cement and in some cases even the bricks of the relationship.

Having fun with would-be clients doesn't always work. When I was a corporate treasurer I caught sight of a rather flattering file note from one bank marketing officer to another declaring that 'you won't get any business from Dan Hodson, but you will have a few laughs'.

Relationships are therefore first and foremost built between people: the salesman with his purchasing opposite number, the premises manager with his opposite numbers at the local council, the boss with members of his team. There are of course the overarching corporate relationships; business of any kind is almost always done in the name of the firm, with the individuals concerned acting as agents - and this may survive nonexistent and/or very lowgrade even thoroughly antipathetic personal relationships, those with a monopolistic supplier, such as utilities. Even here though there is increasing choice, and the special needs and occasional favours and priorities needed from suppliers of, for example, telecommunications, gas and electricity surely give rise to a need to develop personal relationships within the relevant entity.

If the relationship is important, and is potentially based on how people respond to each other, not how firms as firms interact, a major corporate objective must be to somehow depersonalise the relationship, either by ensuring that those handling it are selected so that they will always engender the right reactions, respect and trust, in opposite numbers or to make the overall relationship so important to the counterparty that it can survive the most uncongenial of. human relationships because of mutual need. When I was a marketing

banker, I used to meet some pretty appalling CFOs and Treasurers - pleased with themselves, arrogant and loving the opportunity to twist the tail of some whippersnapper young banker, including one who spent the entire time allotted to our interview talking about the odd totem pole like sculpture outside his offices, and what every layer meant. I felt sure, by the end, that I knew which level was reserved for conscientious young bankers...But I had to grit my teeth and bide my time when being treated this way, since I knew that my employer would value the relationship even with a four letter man on the other side.

It is another key, but subtle role for the Board, in the context of strategic relationship risk management to ensure that this depersonalisation occurs, whilst retaining the benefits (and insuring the underlying risk) associated with the relationship.

Banking relationships

Touching on counterparty risk and the role of individuals in relationship building leads naturally to a discussion of the customer-supplier relationship, in the context of banking products and services, where such risk and approach to marketing plays an important underlying role.

Banking these days is of course a much more sophisticated and broader service for corporates than it was when I began my working life nearly 40 years ago. Then the basic business was about accepting deposits, lending money and moving the latter around, with a few ancillaries like trade credit and foreign exchange; to this could be added the gentlemanly profession of merchant banking which was mainly concerned with the underwriting of new issues and the advice on mergers and acquisitions; and alongside came the company stockbroker. There was usually one of each and the relationships were of long standing. In outline the lack of sharp competition led to little product innovation, and to ologopolistic pricing, but there was the advantage that in theory at least, your banker/merchant banker/ stockbroker was loyal and would stick by you through thick and thin. Furthermore the profession of treasury management was in its infancy, and I can well remember going out to the provinces to sell banking services on behalf of an upstart American bank in the late 60s to find that my corporate opposite number was, as like as not, a rather bored company secretary or a junior member of the accounting staff - often called the cashier - charged with the tedious business of managing banking matters whilst his financial bosses got on with the lordly matter of keeping the accounts. To most of them forward foreign exchange was as alien as integral calculus is to the checkout lady.

But times changed. Led, I must say, by the American invaders, competition became more intense, and products more competitive, complex and better tailored to corporate needs. As a direct result, the new profession of corporate treasury management treasurers arose, became vastly more demanding and looked around for better and more imaginative services, and sharper pricing. At treasurers' fingertips are not only the original banking services, but the whole panoply of products that are commonplace today, with new, and to the corporate cashier of the 60s totally baffling, names: swaps and collars, options of every stripe, lending instruments of every term and repayment schedule, and information technology support which would have left the back office treasury implements of the 60s look like abacuses. Most importantly they are able to pick and choose their suppliers, and whilst the services grew in usefulness and sophistication the number of suppliers have likewise burgeoned.

Your average corporate treasurer is now a highly skilled individual, so much so that one of the main groupings using the ACT's professional training courses are the very bankers who are selling treasurers the services. Where in the past the chap who did the banking was consigned to a corporate cubby hole in the fifth office on the right, he is now an high profile senior executive, quite possibly with profit responsibilities, but certainly with a keen awareness from his colleagues of his ability to impact the bottom line and to assist in their various tasks. He will also be a constant target of the selling techniques of many financial institutions, and will have had plenty of opportunity to ruminate on what is increasingly obvious to observers of the banking scene: there are, by and large, too many banks and suppliers of banking services around. The relationship he engenders will vary from close and longstanding to highly transactional and commoditised, with past and no future expectancy, merely the expediency of today.

What is the right balance? Certainly today's treasurer will enjoy, for his investment in any given banking relationship, however slight, much better products and pricing. He will be able to shop around, but for the most part he will be able to obtain what he needs from a small group of suppliers with whom he has established closer relationships; nonetheless the opportunity cost will be based on the fact that he will frequently be able to get cheaper (albeit usually marginally) services elsewhere, and also, from time to time, better and more innovative ideas. Some suppliers will also appear to provide goods that are so commoditised - foreign exchange and derivative products - that he will hardly think it worth building up the relationship. And his front end cost will be minimal, as he will be besieged by salesmen. So why not always go where the products are cheapest; why pay the insurance premium associated with relationship building?

The answer is twofold. Most corporate banking relationships are based to a greater or lesser degree on creditworthiness or exposure management. As I have argued earlier, this may not be immediately obvious in the more commoditised transactions, but even they have an underlying exposure aspect. No corporate can expect not to have the occasional credit frisson. It is then that the fair-weather friends, who have been used only for single transactions with knife edge pricing, will wither away, and the treasurer will only be able to turn to those who know him and his business for many years, where a relationship of trust and mutual understanding has built up. They will support him when the chips are down.

In addition, a wise treasurer will look to his banking suppliers for innovation and ideas. The latter are more likely provide these to clients/customers with whom there is an established durable relationship of trust and mutual benefit.

The insurance premium is of course cost, direct and opportunity, and, like all insurance premiums, the wise and prudent approach is to pay as little as possible for the most comprehensive cover. On the one hand, it is axiomatic that it would very foolish to allow banking relationships to become so skimpy that when bad times come, as come they will, the resulting banking requirements are hard if not impossible to find. It is therefore necessary to establish a group of core banking relationships, in particular to cover all activities where credit exposure is involved - a necessary insurance premium - and this activity should not forget that suppliers may have limited capacity for credit and other exposure; it may be necessary to have more than one core relationship where such exposure is involved in order to protect the customer's interest and requirements. On the other hand it is also important to maintain a watching brief in the market to ensure that the treasurer is fully aware of pricing and product opportunities, but not to the degree that when wheels fall off, bankers will not be around to help put them back on.

Nor indeed is the customer necessarily the only party who should have strategic relationship insurance. Sometimes the boot may be on entirely the other foo4 and banks which have gone through recent vicissitudes (Barings and its resultant parts, Barclays and NatWest spring to mind) are good examples of this. I have a particularly graphic example of such insurance where it actually benefited both bank and customer. Some twenty years ago, Schroders were going through a bad patch and had, through arrogance and other misdemeanours alienated and in some cases lost clients. The newly appointed Chairman of Schroders, Win Bischoff, went around each client (including Unigate/Uniq where I was FD) admitted that mistakes had been made and asked for a chance to set matters to right. It was a call on longstanding relationships and it worked, certainly for us. Put that way, what else could we do? Our gesture was reciprocated a very short time later when there were rumours that we were about to be the object of a dawn raid, that is a sudden offer to buy a large number of our shares at a price rather higher than market, as the first shot in an unwanted takeover bid, and Schroders without being asked committed to frustrate the raid by offering at a penny higher than the raid price up to a substantial ceiling. In the event there was no raid, but the symbolism of their commitment was unmistakeable.

Finally, an interesting issue arises when the relationship is more with an individual than with a firm, a situation which is more likely to occur for instance in an advisory rather than a capital raising exercise. To what extent is it wise to transfer relationships based on individuals rather than their employers? The temptation will be great in this day and age, when teams of bankers of all kinds are transferring en bloc from one major firm to another. The answer must be judgemental and based on the need for an insurance premium. If a trusted and respected individual moves, the question will be whether moving the relationship will weaken the strategic relationship insurance. If the risk is bearable, because the insurance can be carried elsewhere, or, in the case of this service, there is no risk, then there should be no problem. But a prudent treasurer will be very careful in moving with an individual when the strategic relationship insurance may be damaged. In fact the conclusion must be that, if the insurance motive is real, it is in the interest of the customer to maintain the relationship on a corporate basis, and not with individuals within the bank, except as agents of the latter. The latter must also be true of the bank, who will not be impressed if the long cultivated treasurer of a major client ups and leaves, and his successor is not the slightest bit interested in continuing the relationship. From the bank's viewpoint too, the aim point is the corporate relationship and the personal relationship can be only a means to an end, and not an end in itself.

Employer I employee relationships

Thus the curious and potentially unstable relationship between individuals and their employers as it affects external relationships is clearly an interesting part of the discussion of the interplay between customer and banker. I have also dealt with it in my last lecture, in the context of what seems to me to a breakdown of the level of loyalty and ethical behaviour between employee and employer. I will not go into the details of the argument, which was part of a larger theme based on the idea that whilst City ethics had generally improved in the last 40 years, interpersonal honesty had not, in many cases, driven in large part by the major cultural changes seen in the City. I concluded in this instance that a combination of greed and changed culture had led to an environment in which, in many firms, loyalty between employee and employer was minimal, witness well publicised demarches of teams from one financial institution to another. In my mind both sides were to blame, the employer for dismal human relations management at a time when that profession was making many successful strides forward, and the employee in the context of rather different personal ethics than those of a generation ago.

But the conclusion I draw from my earlier lecture shows that there are both firms and employees who have a scornful, cynical and damaging attitude to this key relationship. This is exacerbated in the case of the City, where there are many examples the firm (professional partnerships for instance) being in reality no more than the sum of the individuals within it, and the two becoming indistinguishable; if the employees depart, the firm is no more. My two further conclusions today are, first, that both sides are forgetting the strategic relationship insurance aspects of a relationship: the current City climate of consolidation and rationalisation is hardly one which suggests job security anywhere, in stark contrast to the situation only a year ago. In simple terms an employee may value a loyal employer I who provides a measure of protection against market and economic downturns, and it is also hard to argue against the proposition that an employee likely to stay is more valuable than one who will up and off at the drop of a hat. A firm's value will be positively affected by the quality and stability of its workforce, the insurance premium being the cost of achieving that. The employees' insurance premium will be the cost of passing over outside opportunities for security and job satisfaction. Both sides will be arguably better off if the level of mutual loyalty and stability were to improve.

Second, the achievement of the latter aim is not so difficult, once the importance of the relationship has been recognised. In today's world, despite cost and performance pressures, the achievement of better quality HR has to be a core objective for the companies that could be affected by mutual disaffection: better career planning, appraisal and objective setting, remuneration packaging and internal communications, and just better one-on-one man management. From the employee's point of view, the period of current uncertainty will have brought a new realism, and in any event much of the high velocity of circulation of teams and individuals will have been a function not just of a bull investment banking market, but also of the rapid evolution of City institutions since Big Bang, now perhaps going through a period of stability.

Again these HR concerns are an important aspect of the Board's strategic relationship risk management.

Other stakeholders

In this lecture I am concentrating on five stakeholders only: customers, suppliers, employees, shareholders and regulators; there are of course many. In an earlier lecture, during last year's course, I made a reasonably well accepted point, that in general terms, if shareholders are the ultimate stakeholders, ahead of all the others, the best way to look after shareholders' interests is to treat each of the other stakeholder groups as well as resources and priorities allow.

Of suppliers, I will only add that the specific reasons for the importance of establishing a good quality relationship with purveyors of banking services applies to suppliers generally: in particular the availability of key supplies when times are tough and the provision of new ideas and products to help enhance the company's own business. To this must be added the importance in a competitive market of good quality suppliers, to give and maintain an edge over market rivals.

Moving on, it used to be that, certainly in public companies, shareholders were part of the capital structure, but remote, and were only likely really to cause problems when things got really bad. In the meantime, it was the company's brokers and merchant bankers who kept shareholders informed, aside from the formal requirements of stock market listing. It is very different now. Shareholders have come to the top of the communication priorities of plcs and it is clear that developing an understanding, as well as clear communications (where allowed under the listing rules) and the establishment of personal contacts can be hugely important both in good and bad times. There are two key objectives: a stock market valuation based on the best possible information, and the ability to get support when needed, for transactions, raising money, going through periods of difficulties and strategic changes of all types. An informed shareholder is more likely to be a supporter, whilst an uninformed one, particularly faced with shocks, can be an instant enemy. An earlier lecture deals in more detail with the executive responsibility for shareholders - Chairman or CEO - concluding that this depends to a large degree on the respective personalities and agreed interaction between the two, but the level at which this responsibility is pitched clearly singles it out for a matter for the Board to be concerned with, and to review on a regular basis.

Another stakeholder area where a board perspective is very important and the relationship should be carefully cultivated is that with the regulator. This is of particular interest in the financial service area, which has relatively close regulator supervision. In one sense the regulator is a routine and continuous relationship, with the latter in many ways taking the lead. But there is one potentially vital aspect of regulation, where the development of relationships at a relatively senior level may pay dividends: the premium for the insurance, to use my earlier terminology. Financial markets, particularly in London where so much of the financial technology cutting edge is based, are in a constant state of expansion, innovation and evolution. One of key tasks of all market participants is 'educating the regulator', for the regulatory approach and conventional wisdom of today may be geared towards yesterday's market and its practices. An absolutely key aspect of relationships with regulators is to ensure through personal contact and interactive contact that they understand what is going on in the markets that they supervise. It is certainly true that when I was CEO of LIFFE we constantly spent a significant amount of time and resource making sure that the leading edge of an endlessly changing market was communicated to the regulator. It is an investment which will pay dividends not only to ensure that the regulatory approach to the market is appropriate, but also to instil confidence from the regulator which may be of great importance in any strategic corporate upheaval - benign or malign - which may require regulatory attention and even approval.

The salutary point is the constant cry in the context of financial crisis and disaster of 'Where were the regulators?' An entirely relevant concomitant question springs to mind: 'What was the Board doing to make sure that the regulators understood not just the company's activities but the practices and risks of the markets in which they were participating?' The names Barings and Equitable Life come inexorably to mind.

Paragons and dragons

I will let Boards off the hook on the one relationship, of overriding importance, but of which they may be only dimly aware and certainly cannot control: the personal assistant or PA (she who in less enlightened days used to be called the secretary) who guards the door of the object of a desired relationship. I still spend measurable amounts of my time attempting to get past these Raragons (it is interesting for aficionados of Scrabble that if one removes PA and adds D the word becomes 'dragon' a highly politically incorrect but often truthful description) and they are often critical in deciding what gets to their boss's attention and what is simply too unimportant or inappropriate. I once knew a secretary (as they were called in those days) who refused to put female callers through to her boss, on the grounds that they might engage his attention, for the simple reason that her own sale purpose in life was to do just that herself. And I had a marvellous one of my own, whom, when I was at Unigate I caught binning a (as it turned out, pukka) extortion letter, on the grounds that it was dearly a joke...It wasn't and the next 48 hours were the most stressful of my business life; we outwitted the perpetrators, I am glad to say.

I often say, like Clausewitz, that time spent in reconnaissance is seldom wasted, and reconnaissance involving getting to know, and hopefully to be liked and trusted by the PA can be a critical relationship investment. Remember, not many senior executives with PAs answer their own telephones, nor demand a log of who has called them. Their cultivation is essential although the level of success will never appear in a corporate risk register.

Conclusion

Before asking my guests for their comments, let me summarise my main conclusions .

An important role for the Board, in the context of strategic risk analysis, is to ensure that key relationships are properly cultivated, as an insurance premium against unusual circumstancesSuch 'insurance' may be critical, particularly in customer-supplier relationships where innovation and product development may be important, as may the availability of goods and services when economic and/or market circumstances are difficultIn banking relationships in particular the establishment of a core of loyal committed banking suppliers may be critical for support at such timesRelationships are based on people, but wise Boards will seek to depersonalise them as far possible. It is unwise, particularly in banking relationships, to put too much emphasis and trust in an individual within an organisation, rather than the latter as a whole.Many boards of City firms are not paying enough attention to the strategic risk associated with poor employee/employer relationsThe Board should pay particular attention to shareholder and, where appropriate, regulator relations. In the case of the latter educating the regulator may be as strategically important as keeping him informed on corporate activities.