Here's how firms can learn from Murdoch

Anthony Hilton

CITY COMMENT

THINK of the fortune they must have spent on risk control at News International down the years and look at the mess the company is in now. It is hard to believe they got value for money.

Or look at BP still reeling from the oil spillage in the Gulf of Mexico; Cadbury, which was badly hit long before the Kraft takeover by a scare over salmonella in its chocolate; Shell, with its inflated reserves; Airbus, and the problems thrown up in the assembly of its superjumbo. No analyst ever complained about a lack of financial sophistication in these companies or about their inadequate financial controls.

But all were hit by the kind of reputational disaster that now batters Rupert Murdoch's empire. And like Murdoch, no one at the top seems to have seen it coming. Whatever risks the boards thought they were measuring or had convinced themselves they understood and were on top of, they were the wrong ones.

A bit of timely research published this week by a team from Cass Business School gives some insight into why. Having made a list of seemingly unassailable companies that all came unstuck, the team of four – Derek Atkins, Anthony Fitzsimmons, Chris Parsons and Alan Punter – set out to discover what if anything these diverse businesses had in common, and in particular whether there were any common underlying weaknesses that made them prone to a crisis, and for that crisis to escalate into a disaster.

Lord (Paul) Myners said the other week that behind every failed company was a failed board, and broadly that is what this research found too. However, it is more subtle and goes rather deeper to isolate seven potential areas of danger, none of which seem exceptional, but all of which sadly seem to need repeating.

They warn for example that boards may simply not be sufficiently competent or, even when competent, too inclined to talk about reward and opportunity and unwilling to engage with the less exciting issues of reputation and licence to operate.

They found disaster was also brought about by poor leadership, particularly when it creates a culture where lip service is paid to ethical rules but the employees all live in a parallel universe where they know all that matters is performance. This pressure may be added to by inappropriate incentives – either explicit ones, where people get paid massive bonuses, or implicit ones, where everyone knows the unspoken rule that only those who deliver can expect to keep their jobs, let alone get promoted.

They note that boards and companies kid themselves with ambiguous mission statements. Cadbury is cited in the report for adopting a slogan "performance driven; values led", which begs the question of which comes first. Let's just say that employees under pressure to reduce waste changed Cadbury's tolerance of salmonella from "zero" to "low". An outbreak and massive product recall followed a few months later.

Risks also arise from businesses which are just too complex – obviously a problem with banks, but an insufficiently appreciated issue in most companies which straddle a range of markets and geographies.

Boards are fooled into believing that because they can Skype anywhere in the world, they actually know what is going on there. They would do the job better if they realised more readily that they often do not even know what is happening under their nose. In the words of joint author Fitzsimmons: "Too many boards live in a rose-tinted bubble."

THE main problem at the root of most of this is communication. Conventional risk-control systems are too narrow in what they cover and – a brave finding this for Airmic, the report's sponsor and the trade association for risk professionals – the people manning the systems are too low status to make their voices heard at high level. This is particularly true when it is those upper echelons that are the cause for concern.

In essence, risk systems tend to be numbers-based, and cover potential hazards or current operations. They can cover hard data, technical knowhow, systems and strategies. What they don't do is handle softer issues such as management style, employee motivation, shared values and corporate culture. They are hopeless at behavioural issues.

So for that matter are male-only boards. There are suggestions a board with a strong female presence is far more likely not to be so blinkered.

This all harks back to a point made in this column before. The trouble with accounting, performance measurement and risk control – and indeed the teaching of business schools – is that they treat companies as if they are mechanical . They assume broadly that they are machines which, for a certain level of inputs, will deliver a predictable level of output. But the greater truth, particularly in the modern era where talent is the big differentiator, is that companies are collections of people, and they are as much biological as mechanical.

Biological behaviour is much harder to predict and control – but somehow businesses are going to have to learn how to do it, and also to learn how to speak truth unto power.

Anthony Hilton's archive:
standard.co.uk/anthonyhilton

Curse of rising inflation is real fear for the City

Russell Lynch

ECONOMIC ANALYSIS

GROWTH is a red herring: inflation is the key. Brace yourself for a bumper crop of new excuses next week as the UK's stuttering economic recovery prepares to disappoint again.

Back in January, it was all about the snow. Ministers breezed around a Downing Street drinks party explaining how the bad weather had knocked 0.5% off growth at the end of 2010. When journalists pointed out the economy had failed to grow even when the impact of the blizzards was stripped out, the fallback line was that most recoveries are "bumpy and uneven".

This time around, when the first estimate for the second quarter is released next week, there's another host of extenuating circumstances: the extra bank holiday for April's Royal Wedding, Japan's tsunami disrupting manufacturing supply chains up and down the country, even public-sector strikes that closed thousands of schools on the final day of the quarter, which may have forced more parents to take time off.

The data so far – plus the Chartered Institute of Purchasing & Supply's closely monitored activity surveys – point towards a low number: 0.2% or 0.3% growth at best, while some City doom-mongers are even pencilling in the UK's second quarter of contraction in the past nine months. On the face of it, a low figure hardly looks like an auspicious start to the toughest year of the Chancellor's deficit-cutting programme.

Growth will be far nearer 1% than 2% this year as a result, triggering the inevitable vociferous calls for a Plan B and bloodcurdling cries of economic doom.

But how much the Office for National Statistics' GDP estimate will actually tell us about the underlying state of the recovery is up for debate.

In fairness to the Chancellor, if there's one less working day in a quarter, it is bound to hurt growth. Similarly, volatile oil and gas extraction industries fell sharply as maintenance work hit production levels: this is likely to knock a couple of percentage points off the second-quarter number.

It has not been all one-way traffic: for example Britons spent almost £400 million on Olympic tickets, which should boost consumer spending. But the point is that the one-off drops we've just seen should hopefully be mirrored in a stronger third-quarter figure as the UK claws back the lost ground.

There are also questions over the quality of the ONS numbers themselves. Their attempts to measure construction, for example, have become a running joke among economists and triggered an internal review. Meanwhile, the Bank of England believes the ONS has overstated the depth of the recession and underestimated the recovery: stronger growth would account for a 300,000 rise in employment in the past year and explain away the UK's puzzlingly low productivity levels per worker.

> 'There are questions over the quality of the Office of National Statistics' growth numbers'

The truth is that a few percentage points either way – a "good" or a "bad" number – and the politicians will make hay, but it's largely irrelevant to the real squeeze at the moment, which is from inflation.

The Chancellor and the Bank of England were already braced for bad news on the cost of living this year, but a 20%-plus rise in oil prices has added enormously to their headaches. Falling real-terms incomes have hammered retailers as inflation (4.2%) streaks ahead of wages (2.3%) and the darkest months may well still be ahead as energy firms hike household bills. Food prices are rising at an annual 6.5% and the news here again will get worse before it gets better.

Prices headache: Chief Secretary to the Treasury Danny Alexander and Chancellor George Osborne

But if 2011 looks like the peak of the pain, the picture should improve in 2012 as better harvests begin to bring down wheat prices. The oil spike is unlikely to be repeated, while this year's VAT rise and higher utility bills will drop out of the inflation figures – hopefully putting wages on course to grow in real terms for the first time in three years.

Good news isn't in great abundance at the moment. But we have to be realistic: recoveries from recessions triggered by financial crises are usually slower than the bounceback from "normal" slumps, so the economy was never going to be punching the lights out this year.

However, falling inflation should eventually ease the pressure consumers and boost growth, as long as the Bank doesn't make any hasty moves on raising interest rates.

At the same time, Osborne should ignore the inevitable calls to ease up deficit-cutting, especially in a climate when markets are tearing strips off Italy because of the size of its debts.

And if he sticks to his guns on the deficit, it makes it easier for the Bank to help him out with lower rates for longer.

The alternative – premature rate hikes for indebted households, rising repossessions, businesses going under – won't be pretty. Then we would really have to start worrying about growth.