

ENCLOSURE A

Towards a new settlement

Less regulation, more responsibility?

In PwC's view, the gap between fine words and genuine action that restores and builds trust will not be closed by further regulation. Even though regulators have an obligation to consider the ethics and culture of the firms they regulate, we believe that regulation is a false remedy for a lack of trust. Society's expectations of business and political leaders are based on their compliance not with detailed rules, but with broader principles and standards of behaviour.

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Regulation will only drive the right behaviour if it is backed up by the right embedded ethical values. Furthermore, experience shows that while you cannot legislate for trust, you can certainly see the effect when it disappears. As Ed Smith and Richard Reeve point out in their paper 'Papering over the cracks?'*, trust is like oxygen, underpinning the law of contract, reducing transaction costs and speeding innovation – and as it gets thinner, the consequences for business and society are hugely damaging.

To try and prevent this damage, societies have traditionally used legislation to plug the gaps when trust is leaking away. But there is an argument that the regulatory reflex has the opposite effect, by creating a form of 'regulated trust' that people will follow the rules, but not that they will necessarily do the right thing. Enron – and arguably the run-up to the banking crisis – demonstrated that black-and-white rules

can and will be circumvented by those with the time, intellect and intent to do it. So you cannot regulate your way to trust: instead it has to be earned, through voluntary behaviour based on sound principles of honesty and integrity.

The shifting landscape of trust brings major implications for UK business, fundamentally reshaping the way it interrelates and interacts with civil society and government. Given the changing dynamics, PwC's view is that the time has come for a new settlement between business and society – one based on less regulation and more responsibility. Creating such a settlement will require an open and forthright public debate.

In our view, all of today's organisations should be on a journey towards the new settlement with society. Progress toward this goal will require active involvement and engagement from three groups

of stakeholders: the senior executive management of businesses; the individuals who are custodians of trust in those organisations, such as the chairs of audit committees; and the authorities and organisations charged with being responsible for maintaining the balance and wellbeing of the economic system.

For all these stakeholders, we believe that an important guiding principle will be recognition of the close linkage between public trust and corporate culture. People trust – or, alternatively, distrust – organisations because of their personal experience of how the people in those organisations behave. So businesses must seek to identify, develop and embed the right culture and behavioural norms that will earn both public trust and business success. That is the journey ahead.

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