

Doing Business in a Global Economy
SCDI Annual Lecture - Aberdeen, 8 January 2008
Paul Walsh, CEO Diageo Plc

Thank you Duncan for that kind introduction, and thank you also to Alan for inviting me to speak here this evening.

I must confess that when I was first approached to deliver this lecture I did ask for more background on the SCDI.

You may be thinking that the invitation to speak in Aberdeen in early January would have been attraction enough for me. But no, I needed a bit more information on the institution.

What sealed the deal was when I examined the aims of the SCDI and saw how closely they chimed with Diageo's aims in, and for, Scotland.

I also admire the organisation's positioning as a pioneer - whether that be leading the way in developing Scotland's international business links over the past 5 decades, establishing the first industrial estate here, or introducing enterprise activities into primary and secondary schools as you have recently done.

We value a pioneering spirit in Diageo - particularly in Scotland.

Those of you familiar with our business will know that our own John Walker was a renowned pioneer himself - exporting Scottish wares all around the world in the 19th Century before Coca Cola had managed to get outside the US. He'd have most certainly been a member of the SCDI.

Aberdeen itself is recognised for its outward looking pioneering spirit, recasting itself over the last 30 years from a regional port dependent upon fishing, to become the centre of the UK's energy industry, as well as one of Europe's most enterprising regions. So its apt we're here this evening

A pioneering spirit, and its importance in 21st Century business, will be a theme of my remarks.

My remarks this evening

This evening I want to cover four areas.

Firstly, my view of Scotland's position in a global economy - and in particular the role I see for business leaders such as yourselves in shaping that position.

Second, I want to examine an attitude to business I call 'Globality' - the capacity to see and embrace international opportunity.

Third, I will outline my view of what constitutes a responsible business in the 21st Century - for me a key growth driver for any company today.

Finally, I want to say a little bit about the importance of fostering great leadership in business, and why I regard this as a critical competitive advantage in the modern economy.

Diageo

But before I do that let me take a few minutes to tell you a bit about Diageo, and more particularly our business in Scotland.

It always strikes me as interesting that Diageo is, through our ancestors in Guinness, Grand Met and Seagram, a company steeped in history.

Yet, somewhat paradoxically, we are actually a very young company. 3 weeks ago, on the 17th of December, we marked what is only the 10th anniversary of our creation. Though what a 10 years it has been.

Perhaps the most significant moment in our development came in the summer of 2001 when the global leadership of Diageo met in Dublin to map out a strategy for the company for the subsequent 5 years and beyond.

I was CEO of Diageo for less than a year at that point, and we were all of us aware that, nearly 4 years on from the merger of Guinness and Grand Met, it was time to shift gear in the evolution of our business.

That conference was where we set out on our journey from international conglomerate, to becoming the world's leading premium drinks business we are today.

It was a radical and brave decision to embark on that journey. The implications of it were enormous.

We would, over the course of the following two years exit our food interests completely, disposing of Pillsbury - which I had led - to General Mills, Burger King to Texas Pacific, and all other interests which were not core to our new goal.

We acquired Seagram's spirits and wine brands, a deal which not only gave us some great brands such as Captain Morgan Rum and Crown Royal Whiskey, but most importantly a significantly greater footprint in the US marketplace.

It was a fast transition, but fortune has favoured the brave and the strategy we adopted has proved to be the right one.

It has not been without pain, but Diageo has today achieved our goal of being the world's leading premium drinks business.

We have an outstanding collection of beverage alcohol brands across the spirits, wine and beer categories.

We are a truly global company with more than 22,000 employees. We trade in over 180 markets around the world, and are listed on both the London and New York Stock Exchanges.

The word Diageo comes from the Latin for day - 'Dia' - and the Greek for world - 'Geo'. We take this to mean that *every day, everywhere* people are enjoying our brands.

And what brands they are.

They account for nearly two-thirds of the volume of the 10 largest spirits brands in the world, and we have more category leaders than any other drinks company.

Smirnoff is the world's leading premium international vodka and with sales in excess of 24 million cases, it is the number one spirits brand in the world by retail value.

Four bottles of Johnnie Walker, the world's favourite Scotch whisky, are consumed every second.

Ten million glasses of Guinness are enjoyed every single day around the world.

These brands are amazingly powerful, and they are core to why we are a successful company.

Our financial results for the year ending June 2007 show that Diageo is able to drive performance that is both successful and enduring. For the seventh consecutive year we grew our top and bottom line, and we did so in both reported and organic terms.

Our sales were well over £9 billion, and we had an operating profit of over £2 billion, up almost 9% year on year. And we continued to deliver operating margin improvement.

Diageo in Scotland

So what part does Scotland play in delivering that outstanding performance?

Well, despite being a comparatively small consumer market for us, I am often heard to say that Scotland is disproportionately important to Diageo.

Disproportionately important to Diageo - and the reasons why are clear.

Scotland is Diageo's largest supply centre, responsible for producing and packaging annually:

- > Just over 33 million cases of Scotch whiskies such as Johnnie Walker, J&B and Bell's;
- > Around 12 million cases of white spirits such as Smirnoff vodka, Tanqueray and Gordon's Gins;
- > 2 million cases of other spirit such as Bulleit Bourbon;
- > and some 6 million cases of Ready To Drink brands such as Smirnoff Ice and Archers Aqua.

90% of the brands produced in Scotland are then sold outside of Great Britain. It is a fantastic export success story.

I am proud that we are the leading player in the Scotch whisky industry. We operate 27 malt distilleries, two grain distilleries, and a half share in a third grain distillery. Visitor centres are located at 12 of our operations throughout Scotland, playing host to over 200,000 visitors annually.

While the recent history of Aberdeen has been dominated by oil, we should also note that the city and its hinterland are also important to the Scotch Whisky industry.

Royal Lochnagar, which we know within Diageo as the home of malt whisky, is a fantastic local example. Situated on the south side of the Dee close to Balmoral, it produces one of Scotland's most exclusive whiskies.

A visit there is well worthwhile.

You can learn about the process, see the distillers tending to the traditional mashtun and gleaming copper stills, and at the end you'll get a complimentary dram.

You'll also be following in the footsteps of Queen Victoria and Prince Albert who, after visiting the distillery in 1848, were so impressed they granted it a Royal Warrant. As I said, it's very good whisky.

The Scotch Whisky industry is imbued with a new optimism for the future. The latest statistical analysis of Scottish exports shows that food and drink - of which Scotch Whisky is by far the largest part - is the biggest earning export after oil and gas, amounting to £3.7 billion.

Just last week I was proud to take over as Chairman of the Scotch Whisky Association, and it's always welcome to have such good news to greet you in a new job.

One of the key campaigns I will be driving in my Chairmanship is ways in which we can protect Scotch Whisky's position as a product, and in particular prevent inferior beverages being passed off as the same.

In doing so I want to perpetually safeguard Scotch Whisky's position as a fantastic export of high quality, unique to this country.

This is particularly important because the numbers I quote confirm the great importance of Scotch Whisky to the Scottish and UK economy. A total of 41,000 jobs depend on the industry, of which 10,000 are people in direct employment. 3,000 of these jobs are in rural areas, making a critical contribution to local commerce.

For our part, Diageo employs 4,000 people on 50 separate sites in Scotland, with a further 12,000 indirect jobs supported across the country.

There is a £1.7bn asset base, delivering over £3bn in revenue - about a third of our global total.

We have eight main warehousing sites in Scotland which, at any one time, will store over seven million casks. These operations are supported by two cooperages, and a coppersmiths which manufactures all the stills, pipes and vessels at the company's distilleries.

Packaging is focused at three plants: Leven in Fife, Kilmarnock in Ayrshire, and Shieldhall near Glasgow which is the largest - and fastest - plant of its type in the industry.

The Gleneagles Hotel, also owned by us, is Scotland's first AA Five Red Star hotel - a world-class resort offering guests an unrivalled choice of sports and leisure facilities, including three championship golf courses.

We're looking forward to hosting the Ryder Cup there in 2014.

As a company we spend over £700 million a year on products and services, with almost £300 million of that figure spent in Scotland.

You can see therefore why we say Scotland is disproportionately important to Diageo's success.

But fundamental to that success is the fact that our business looks out from Scotland and not inward.

Of course we recognise our responsibilities locally - to our people, the environment, and our communities. But we never lose sight of the fact that our Scottish operations play a truly global role - exporting, trading, developing, pioneering.

These are the attributes of a great Scottish business.

The Role for Scottish Business in the Global Economy

Scots are justifiably proud of their country.

There is a tangible patriotism wherever one goes here, and a manifest passion for doing great things in and for Scotland. Outside of sport perhaps, nowhere is that more true than in Scottish industry.

The challenge I would argue for all of us as business people operating here is to ensure that pride and passion don't lead to introspection. That we consistently recognise that, for most of us, our business success lies in looking *outside* of Scotland - indeed outside of the UK.

Scotland has decent assets to work with as a global business player.

A competitive economy, a skilled workforce, good infrastructure, and a global renown for the quality of its goods.

While these are all areas where improvements can be made, it is still quite a platform to build from - provided we consistently seek and embrace international opportunity. In Diageo we call this mindset 'Globality'.

Globality

In coining the term 'globality' I was endeavouring to give a name to a new kind of business thinking for Diageo - one that was unconstrained by geographical boundaries or the demarcation lines of business units.

As a company we recognised that if we are to compete effectively in the 180 markets in which we operate, and drive true value from our unrivalled scale and reach, then we needed to think and operate in a truly global way.

Many companies talk about the importance of scale. Scale can be useful, of course. But the real opportunities arise not only from scale, but from global reach.

Diageo today is driving performance across a broadly based platform of geographies, as well as brands.

We have the advantage of being able to access growth opportunities from different parts of the world at different times, and in different circumstances.

And by being able to do so we are in a position of being able to generate sustainable, organic growth and superior value for our shareholders.

The environment in which global business operates has changed very substantially and very rapidly - and will continue to do so. Outside the UK, we have to understand that while the US and EU remain primary markets, the importance of emerging economies cannot be overstated.

It is intriguing to me that in spite of the recent travails in the global money markets the emerging economies appear, so far, unaffected.

Our experience at Diageo is that the growth trajectories in markets such as Brazil, Russia, India, China, Mexico, Vietnam, Nigeria and Venezuela have carried on as before. If anything the momentum is increasing.

We are seeing a new business paradigm created, whereby the old maxim that if the US sneezes the rest of the world catches a cold may no longer be true.

These emerging economies not only offer a fantastic opportunity for future growth but a chance to spread your exposure - to be able to offset the impact of the inevitable peaks and troughs of mature markets for the next 20 years and more.

It is all too easy in business to become parochial in one's thinking, to over-prioritise a market or brand because you happen to be close to it, and fail to see a bigger opportunity elsewhere.

Today's key determinants of where to do business are simply these - where are the consumers, where is the talent, and does the product or service have the quality and economics to compete? Those are questions I want my company's leaders to consider, and those which I believe Scotland's business leaders should also consider.

Be pioneers in these new markets.

Responsibility as a driver for growth

Let me turn now to an increasingly critical area of focus for many companies - responsible behaviour - and my contention that responsibility is actually a growth driver for a 21st century business.

Today, it is not enough simply to be a successful company.

There is also an increasing focus from stakeholders on how you conduct your business. This is particularly acute in the developing world - the very place our growth opportunities are over the next 15 years.

But what does being a 'responsible business' actually mean?

The definition of corporate responsibility has become extremely stretched, with many companies having chosen to apply their own interpretation of what it constitutes.

Those interpretations range from the bare minimum standards that local regulation requires, to extreme standards of personal and professional probity and altruism, which go beyond what can reasonably be expected of a business which still wants to make money.

The problem with some companies' positions is that they start from a premise that corporate responsibility is simply an onerous burden on business - something that brings cost and inconvenience with no benefit. Consequently the rigour applied when assessing an appropriate strategy for responsibility is limited to say the least.

That is a great shame. Because in doing so they are missing out on an opportunity to enhance their business, and to increase profitability, not in spite of, but because of, responsible behaviour.

In my view an astute modern business leader should not treat responsible behaviour as a tick-box process, or a marketing exercise.

Rather it is a driver of long-term growth - an essential component for a company's commercial success.

Let me offer you my view of what constitutes responsibility - or being a good corporate citizen.

After the Enron and WorldCom scandals in the US many companies focused on financial probity as being the defining factor of what constitutes behaving responsibly. Changes to reporting rules, notably Sarbanes Oxley, certainly reinforced that perception.

I believe this is too narrow a definition and not sufficiently exacting.

Of course it is critically important for a business, particularly a public company, to accurately and honestly report its financial position. It shouldn't have taken major scandals and the collapse of once great companies to make business fully understand that obligation.

It is a fundamental ethical duty of care owed to investors, the markets and regulators.

These are certainly important stakeholders, but they are not the only stakeholders in a business.

Many leaders believe that their duty of responsibility begins and ends with the needs of investors. They focus on this stakeholder audience to the exclusion of all others.

That exclusivity is unsustainable in a 21st century business.

Society's expectations have changed, and the standards by which we are judged have also changed - dramatically. Financial success is no longer the only index of whether a company is regarded as a leader.

Sustainable performance, as well as a company's reputation, is now built upon much broader foundations.

Today, other stakeholders have to be considered - a company's employees, its commercial partners including customers and suppliers, the communities in which it operates, the media which covers the company and, of course, its consumers.

In this new dispensation no stakeholder audience can be ignored. Each has to be engaged because each is important in its own right - though, of course, with different degrees of priority.

Investors want us to be successful and profitable but to do so in a *sustainable* way - driving long-term value for them and mitigating risk.

Consumers want us to make great quality products, *marketed in a responsible way*, which help them to celebrate the big events in their lives, and brighten the small ones.

Employees want to work for a company of which they *feel proud*, one which allows them to realise their full potential irrespective of their background.

Government, regulators and NGOs want to see companies *behave responsibly in the way in which we market and sell our products*, to recognise and mitigate our social and environmental impact, and to be a constructive partner to them - seeking solutions rather than presenting obstacles.

Commercial partners, including our customers, want to work with a company, which acts fairly, *and with transparency* in our dealings.

The communities in which we operate and manufacture expect us to be a *good neighbour*.

The media, as both a stakeholder and a channel for reaching others, want the company to be as open with them as we can be but, more than that, they see themselves as having a role in *policing the good conduct* of our business.

Whatever your corporate background, whether in consumer goods or not, I have little doubt that you will recognise most of these constituencies of interest. They are certainly all present here in Scotland.

You will also recognise the top-line relationship drivers for each that I have laid out. A common thread through all of them is clear.

Every stakeholder wants a company to behave responsibly in its dealings - to be fair in how we operate, and to go the extra mile where possible to enhance the relationship. That stakeholder condition will be consistent with any business, large or small.

If I sound something of a zealot on the subject it is because I am convinced that behaving responsibly adds value to any business. Not a veneer of responsibility, but responsibility which is central to a company's operations - in its DNA if you will.

By observing your company's activities through the lens of your stakeholder audiences you can find the sweet spot of their expectations which will tell you where the benchmark for responsible behaviour lies for your business.

It is the most exacting of tests but it is the right one to apply.

And if you get it right the benefits are extremely tangible, and will positively impact your top and bottom lines.

- > Investor confidence will grow both in your financial forecasting, and in your capacity to mitigate risks to your licence to operate.
- > The rise of ethical consumerism means people will favour your goods over others and be more tolerant of failures when they occur
- > Super-engaged employees, proud of where they work, will go the extra mile for the company, producing more, and acting as brand ambassadors

- > Governments, regulators and NGOs will have faith in your intent to self-regulate, and therefore see limited need for market interventions, including taxation increases
- > Commercial partners, proud of their own reputation, will favour doing business with companies who demonstrate high standards of ethical behaviour over those who do not
- > The support of local communities where a company operates will help operational efficiency, for example securing planning permissions or driving infrastructure improvements
- > The media will be pre-disposed to report positively on your company and its products - driving sales.

All of these benefits to a company - driven by responsible behaviour - which in turn positively impacts on society. A truly virtuous circle, and one I commend to you.

Leadership

I want to conclude my remarks today by saying something on what I regard as the most important aspect of our collective professional development in the 21st Century, and that is leadership.

For me the defining competitive differentiator for companies in an increasingly tough global business environment over the next decade will be the quality of leaders within those companies.

At Diageo we are investing significantly in an ambitious leadership development programme which will see each of our top 900 people - including myself and our Executive Committee - undergo an intensive year long programme to grow us to our full potential as leaders.

The programme is a combination of extensive one-to-one coaching, group events, and work assignments.

The first 90 'graduates' have completed it, and the acclaim for the benefits of the experience has been universal.

This is not a course designed to create 'a Diageo way of leadership'. In point of fact I do not believe that true leadership can be anything other than personal to the individual.

That is why the course is focused on developing each person rather than the group.

However we have prescribed a detailed set of values for ourselves in terms of a Leadership Standard we aspire to. To give you a flavour:

- > We want our leaders to be authentic, to stand for what they feel is right and important, and to do what they say without exception.
- > We want our leaders to create possibilities, to energise and inspire others to deliver the exceptional.

- > We want our leaders to create the conditions for our people to succeed, to know their people and invest time in their growth.
- > We want our leaders to focus on consistently delivering great performance, demonstrating rigour and brilliant execution.
- > And we want our leaders to grow themselves, to have the humility to be open to learning and ideas from others.

Simple though these principles may be they are well worth considering in the context of your own performance as a leader. Are you as good as you could be?

The reason we are investing so much time and money behind this programme is partly because we want to develop our people, but also because we have identified a direct correlation between great leadership, and great performance by their business units.

One significant indicator, among many, of that trend is contained in our annual employee survey.

We can clearly see from the data there that 92% of those markets where we have high levels of employee engagement - which in turn relates directly to strong leadership - deliver on or exceed all their performance targets.

So leadership is therefore a performance driver for Diageo, and for me will be key to our continuing professional edge over our competition in the next 5-10 years.

In my view, any company which is not focusing on this area as a matter of priority is not acting in the medium term interests of your business.

In conclusion

Let me close my remarks this evening by reiterating my belief in the capacity of Scottish business to achieve great things on a world stage. I see this evidenced every day in my own company.

I urge you all to think global in your business endeavours - the prize is potentially fantastic if you do.

Embrace responsibility as a driver of growth, not a burden to be carried under sufferance.

And understand the power of great leadership to business success - but more than that have the humility to consider how you yourself can develop as a leader.

Thank you.