BALANCING MULTIPLE STAKEHOLDERS:

WHAT'S A CEO TO DO?

Canada's Outstanding CEO of the Year for 2007, Gord Nixon of RBC Financial Group, talks to Dean Roger Martin about some of his biggest challenges and opportunities as chief executive of Canada's largest bank.

Interview by **Roger Martin**

Roger Martin: Global capital markets are in turmoil at the moment. What key challenges is RBC facing?

Gord Nixon: We are living in a new world today – even relative to where we were just six months ago. We've been through a ten year 'party' where there's been way too much consumed, and we're now dealing with a hangover that is painful and will last a lot longer than people expected. Our key challenge in the short term is navigating through these choppy waters. Every day there are new challenges in the market – for instance, write downs as a result of what started off as a sub-prime problem, and a real estate situation in the U.S. that has clearly spread into other sectors and asset classes. Being a large global financial institution in a world where markets are in disarray – some might even say crisis – isn't easy. As the crisis spreads into the general markets –from Bay Street and Wall Street to Main Street – the operating environment for corporations and financial institutions will be more difficult than it has been in quite some time. GDP growth of three or four per cent and financial services growth of six or seven per cent – which we've experienced recently – is just not going to happen. So making sure that we manage our organization effectively in a much more difficult operating environment is challenge number two. Being very diligent from a risk management perspective will be essential over the next couple of years. A lot of mistakes have been covered up in our industry by the great markets of recent years, but that is no longer the case. Operational excellence is more important than ever.

And on the opportunity front?

For firms (such as ours) that have managed through the turmoil effectively and maintained a strong credit rating, I think it will present opportunities as credit spreads widen globally. It's not

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necessarily a good thing for borrowers, but it should be positive for firms that have the ability to extend their balance sheet and take advantage of the situation. Over the last five years there has been a tremendous amount of leveraging and disintermediation, but I think there will be far less of that; in fact, I think we'll see a reversal of this trend, and that things like balance sheets, customer relationships – some of the things RBC does well – will become even more valuable.

Many of our competitors are dealing with the industry turmoil by restructuring their businesses, and I think we'll see another round of consolidation – breaking-up of companies because the markets demand it or because balance sheets and capital requirements demand it. All of that creates opportunities. As a financial services firm, you want to be in a position where you've got a high degree of optionality to take advantage of these opportunities, whether it be through acquisition or allocating capital to businesses that have high returns. We aim to maximize our optionality as things unfold over the next couple of years.

You were recently quoted as saying, "Welcome to the new world of investing, where guilt and pride are becoming as much a part of the mix as ROI." What did you mean?

I was referring to a media article that was circulating at the time about a woman who was very proud of her returns in tobacco stocks, but was too embarrassed to admit to her friends that she actually owned tobacco stocks. This was discussed at a workshop we held on the importance of sustainable and responsible investing. There is no question that in today's world, returns remain a very important criteria from an investment perspective; but how people generate those returns – what they invest in, and governance around responsible investing – are becoming equally important. Not to suggest that guilt and pride necessarily compromise return on investment: the good news is that they are not mutually exclusive.

RBC was recently named by *Newsweek* as the top large company in the world at effectively managing environmental risks; congratulations! Tell us about one of your latest initiatives, 'The Blue Water Project.'

There is no shortage of environmental issues that we could have chosen to support, but we believe that access to water will be the most significant issue facing the world in the coming decades. Only three per cent of the Earth's supply of water is fresh, and this precious supply will be threatened even further as we embark on an era characterized by climate change and population growth. The need for better fresh water management is critical because *everyone* on the planet needs fresh water. Shortages and access to clean water are already a growing problem, everywhere from Africa to Australia to California. The **Blue Water Project** is a $50-million commitment over the next 10 years by RBC to support global solutions for freshwater preservation, conservation and access in Canada and around the world. We felt it was important to focus on an area where we can make a difference, and where there's a natural affiliation with our brand (since Canada has one of the world's largest supplies of fresh water.) To kick off the RBC Blue Water Project, we announced a commitment of $10 million over 10 years – the largest donation in our history – to the **ONE DROP Foundation** to support a host of water projects in Canada and developing nations. As a founding partner of ONE DROP, we are proud to join forces with another Canadian organization, **Cirque du Soleil**, to make a difference in the world.

You have earned a reputation for being outspoken on some key non-financial topics, including diversity and Canada's prosperity. Why are these issues so important to you?

Rightly or wrongly, CEOs – along with business school deans – are put in a position where we have the ability to speak out on issues we believe are important. Obviously Canada's prosperity has a big impact on RBC's ability to succeed, because while international markets are increasingly important to our organization, our most important market is right here in Canada. You and I co-authored an article for *The Globe and Mail* last July ["Growing Global Leaders: The Hollowing-Out Solution"], so I know we agree that Canada is not necessarily maximizing its potential globally. I have tried to take a fairly public position in terms of ensuring that our views on these important issues are heard, to ensure that Canadian businesses – small, medium or large – have every advantage and capability required to compete globally.

The diversity issue is very much related to prosperity, because it's an issue of human resources. We all know about Canada's demographics: we have an ageing population and a shortage of skilled workers, which will soon intensify. Canada is a wonderful example of the value of diversity, and this is an opportunity for us to maximize the return we can get from the massive human resource potential in this country. While we are a shining example of successful multiculturalism, we are not without our problems: a tremendous number of immigrants come to Canada every year, and we have not done a good job of maximizing their potential. This is very important to Canada's – as well as RBC's – future.

Have you seen any progress since our *Globe and Mail* article appeared?

The article definitely helped to put these issues on the front burner, where they belong. Since then, the government has put together a Competition Panel, under **Red Wilson**, to look at what some people like to refer to as Canada's 'hollowing out.' In our article we went out of our way to say that people should stop talking about hollowing out, and just talk about how to maximize Canada's competitive position in the world, and that's precisely what this panel is looking at.

There has also been a separate commission formed to look at taxation – which I consider to be the 'grandaddy' issue of them all. Whenever I talk about tax issues I am perceived as a greedy CEO looking to generate more after-tax earnings for his organization, but the truth is, we are no longer competing against other banks or telecommunications companies or mining companies down the street or across the country: we are competing on a global stage, and when people make decisions in terms of where they want to allocate capital or set up head offices, a number of factors come into that. That's why the work being done at the **Martin Prosperity Institute** by **Richard Florida** and his team is so important. They are focusing on all of these issues, which at their core revolve around human issues like diversity and culture; but they also revolve around taxation, because when we allocate capital, we have to make fiduciary decisions based on where we can maximize our return, and Canada is undeniably a high-tax jurisdiction. Our aggregate taxation rates in this country are actually quite competitive by international standards, but at the corporate level, we have very high marginal effective tax rates. We must continue to make progress on this front, because we're competing not just with the U.S. but with Scandinavian countries and Singapore and Ireland – not to mention emerging-market countries, all of which have very aggressive tax rates in terms of attracting investment.

How is RBC dealing with emerging markets?

I just got back from India last week, where we opened a new branch office. The challenge for us is quite different from other banks like **HSBC**, which actually has a history in emerging markets. It's important to recognize that our competitive strengths revolve around our history and track record in Canada and our strengths in Europe and the U.S. Hundreds of foreign banks are now operating in China and India, but the vast majority of them will not be successful – notwithstanding the fact that those markets may be growing at 10 to 12 per cent a year. The key for RBC is to find areas where we can play into our competitive strengths, and that's what we're trying to do in both China and India. Areas where we are strong globally – like global private banking, wealth management and our capital markets and trading businesses – are our focus in emerging markets. I'm proud to say that in China, while we are not large in terms of scale, we are profitable, and we will continue to build on that. But we have to be patient and make investments for the long term.

Do you think we will see more of the ABN-AMRO 'consortium approach' – where firms get together and buy things up, then split up the proceeds?

I do think there will be a lot of restructuring in the industry. The problem with consortium bids is that they're very difficult to execute. The one you mention is one of the only ones in the financial services sector. I was actually directly involved in the merger of the three telephone companies in Atlantic Canada many years ago, and I can tell you that two-party transactions are complicated enough, but when you get into three or four parties it gets extremely complicated. Having said that, I think the answer is yes, we will see more of it, and there is a good chance we will also see the break-up of some large financial services companies, either because their balance sheets will demand it or their investors will demand it. We've already seen that with the hedge funds pressuring banks like **CitiGroup**, **UBS**, HSBC and others to look at breaking up their operations, to separate their investment operations from their wealth management operations; as that pressure builds and transactions happen, I think we'll see opportunities and different ways for organizations to take advantage of those assets that are sold or parcelled and then broken up.

How does Canada's banking system stack up globally?

Our banking system is a shining example in the world today – and not just because we haven't suffered as much as some of the U.S. or European banks. If you look at the delivery of financial services within this country, at the quality of the technology and the products that are provided, it's something we don't get much credit for. It's a lot easier to be critical of the big banks and beat them up than it is to recognize their strengths; but I can tell you that internationally, Canada's banking and financial system is something that people should be very proud of. If you don't believe me, go and do some banking in the U.S. or somewhere in Europe, where you will pay a lot more, and you won't get the same services or technology that you get right here in Canada.

With respect to RBC, we are clearly the most diversified of the Canadian banks: we are number one or two in virtually every sector of the financial services industry in Canada, not just banking (where **TD** is a fierce competitor) but asset management, credit cards, wealth management, insurance and capital markets. While we continue to invest significantly in all areas of financial services, most of our Canadian competitors tend to focus more on one or two areas. One question that I get from time to time is, 'are you big enough to be involved in so many areas?' This is a very good strategic question: should you be focused and dedicate a lot of your capital to just one area or are you better off to be diversified? My view is that there is no right or wrong answer. For RBC, diversification has been a very sound strategy. Frankly, it's provided us with some degree of stability as our businesses perform differently in different environments. For example, we are very invested in the capital markets business relative to many of our competitors, but some of the diversification of our earnings has been very beneficial as the capital markets business has gone through a difficult time in its cycle.

What is coming down the 'strategic pipe' at RBC?

On the personal commercial banking side and the wealth management side of our business, we've been investing outside of Canada – both in the United States and internationally. One of our recent acquisitions is **Alabama National Bank**, a 1.6-billion dollar acquisition that reflects our ongoing intention to build our Southeast U.S. banking capability. We now have about 430 branches in the Southeast and very strong presence in North Carolina, Alabama, Georgia and Florida. In addition to that, we've been looking at a lot of opportunities in the wealth management business both in the U.S. and elsewhere. As a result of what has happened in the international markets, we may be presented with opportunities to do some things that are more transformational in nature; we want to be well prepared to respond in the event that certain opportunities present themselves. However, we would never buy a business for the sake of expanding our operations if it were not consistent with our competitive strengths. There has been – and will be – lots for sale: one of the blessings of financial services (but it can also be a curse) is that we generate a lot of capital, and one of our main responsibilities is to appropriately allocate and invest that capital, whether that means back into our existing business or adding to it. I think the worst mistake people can make is to invest for the sake of investing.

For those in the audience who aspire to reach the CEO-level one day, what advice do you have?

There is no such thing as a prototypical CEO, but I would say that one of the things that is important in terms of building a career is paying attention to mentorship. It's very important for organizations to provide mentoring opportunities, and it's a two way street: we need to step up as mentors too. This has certainly been very important to my career. In addition, particularly in large companies, the ability to work with different types of people and build consensus, to develop a common purpose and a sense of teamwork within an organization is extremely important. The days of aggressive autocratic CEOs are by-and-large gone. As a CEO you have to constantly be looking for ways to improve your management capability and your interface with people. I know what my personal strengths and weaknesses are: people aren't shy about telling you these things, particularly when it's done confidentially (which is the way we do it.) Overall, you are only as good as your people: I'm only as good as my management team, and they are only as good as their operating committees, and the operating committees are only as good as the 70,000 employees who make the bank work day in and day out.

What would you like your legacy to be?

In my view, true legacies are built by people like **Ted Rogers**, **Issy Sharp**, **Peter Munk** and **Jim Balsillie** – people who create companies from scratch and build them into large organizations over an extended period of time. When you look at most large public companies, Royal Bank included, we have a 140-plus year history, and the average tenure of a CEO is somewhere between five and ten years. If every CEO was just trying to build their own legacy, half of them would be spending their time unwinding their predecessor's legacy. CEOs of large public companies *inherit* great legacies, and that's what I've done at RBC. Our organization has been built up over many years by a lot of wonderful individuals, including the leaders of the organization.

Having said that, I do think it is essential for the CEO of any public company to recognize that modern business is extremely dynamic. CEOs should be accountable for ensuring that their organizations continue to move forward and evolve. When I look back at my time as CEO, in five years we've gone from the 51st largest bank in the world to 19th, and sixth in North America. Of course I'm proud of that; but part of it is due to the investments we've made and our operational performance, and part is a result of the mistakes that our competitors have made – investments that have actually destroyed value. Assuming that I remain with the organization for a number of years going forward (which hopefully is a fair assumption) I want to look back and say that I took an organization that was strong and successful and had a great history, and I made it even stronger and more successful, with an even greater history. ***R***

This interview took place at the Rotman School on February 13, 2008.
For more about Canada's Outstanding CEO of the Year for 2007, visit ceoaward-canada.org/history