

Dick Olver, Chairman BAE Systems

Tomorrow's Company — Tomorrow's Value Lecture Series

Hello, ladies and gentlemen.

I'm delighted to have been invited to deliver the latest in an ongoing series of lectures for Tomorrow's Company, an organisation whom we at BAE Systems have been proud to support for many years and whose aims we share and support.

The overarching theme of the series is 'Tomorrow's Value'. Which inevitably prompts this question: 'How will the way tomorrow's companies create value, differ from today's or indeed yesterday's?'

The short answer is: 'quite a lot'. While there are some consistent imperatives for business success - right product, right place, right price, right customer; there are also fundamental changes under way in the attributes that mark out the highest performing businesses. These changes are so profound that they may indicate a shifting of the tectonic plates of capitalism.

What's happening? It seems that the longest recession since the 19th Century, coupled with trends such as global connectivity and growing environmental and social awareness, has altered perceptions of business value: what it is; how you create it; how you sustain it; and what destroys it.

As this reshaping of the concept of value continues, I believe three clear trends are emerging.

- First, to generate their full potential value, companies today must have a culture, governance and ways of behaving that are values-based. This cultural alignment is becoming a prerequisite for each company's licence to operate and ultimately its survival as an organisation.
- Second, even the smallest companies must now think global and the biggest will fail if they don't. The internationalisation of business and information means a company's competitors — and also its own culture — are no longer contained within, or limited by, national borders.
- And third, all companies must contribute not only to their own value, but also to the value of the societies in which they operate. They do this by supporting and meeting the aspirations of those societies: realising human potential and adding innovation and ideas.

In combination, I believe these three seismic shifts are reshaping the business landscape for tomorrow's companies. Given this background, let me turn to BAE Systems, and the journey we've been undertaking through this shifting landscape.

So, where to begin?

BAE Systems has changed a great deal during the nine years since I became chairman. Among other things, we've dealt with falling defence budgets in our historical major markets, adjusted to a more uncertain and volatile world and innovated our way into new, fast-expanding areas like cyber security.

Those changes alone could be described as a transformation. But we've also undergone a far more fundamental metamorphosis that goes well beyond our products, services and revenue mix. It's in the underlying culture and values of our business and our people, everywhere we operate, and in everything we do.

The culture we've tried to develop is one in which our people take the company's core ethical values into account in every decision they take. One where doing the right thing becomes an

almost subconscious response. And one where — within the constraints of customer confidentiality — we are as open as we possibly can be about what we do and why. It's not just about what we do but how we do it.

In a global business as large, complex and diverse as ours, a cultural transformation like this doesn't happen overnight. But looking back, we've come a long way in just a few years.

Today, we're a company that has the most stringent anti-corruption and compliance standards, not just of any defence company, but across business generally. A company that has a code of responsible business conduct which other companies come to us to learn from. And a company with a reputation for responsible business behaviour that has allowed us to remain the UK's leading manufacturing exporter, and also to become a major and trusted supplier to the Pentagon, as one of America's top ten defence and security companies.

An external benchmark of the progress we've made is that Transparency International, the independent civil society organisation leading the global fight against corruption, ranked us fourth out of 129 companies in its latest defence industry anti-corruption index.

Transparency International also stresses that we've still got further to go. And we agree. Everyone in BAE Systems knows that our journey of culture change is far from over. Indeed, it never will be complete, which is why we've put in place a robust mechanism for continuous improvement. This is designed to sustain our momentum and drive the on-going development and embedding of our open and principled business culture through future decades.

While our journey will continue what we can say today is that we're a recognised leader in business conduct. A far cry from the way BAE Systems was perceived in the early years of the Millennium.

Clearly, we can't undo the past. Let me be clear: mistakes were made. But those mistakes could only occur because the corporate governance, ethos and structures in place at the time allowed them to. And the proactive changes we've made are designed to ensure they won't be repeated.

Of course, no company can guarantee that it will always prevent individuals from acting in breach of its standards. But today we have the systems and procedures in place to guard against this and, most important of all, a collective determination among the tens of thousands of men and women in our workforce that irresponsible behaviour will never be tolerated.

If this all sounds cute and cuddly, it shouldn't. As I've already highlighted, shared and consistent ethical values are at the heart of today's most successful businesses.

And my experience over the years in different organisations in different parts of the world has confirmed time and again, that a commitment to responsible business behaviour is the bedrock of strong performance.

So our transformation isn't just about building an ethical culture but about building a sustainable, successful and vibrant company. Because what a company values and the way it and its people behave in their business dealings are fundamental to its ability to compete and grow over the long term.

This link between ethics and performance is now far more widely recognised across all sectors than it was when we set out on our journey. I'm proud that BAE Systems has led the way along a path that is now being followed by other organisations in so many industries.

I'd also like to reject the view that there is a conflict between good business behaviour and strong financial returns. Exhibiting a consistently responsible approach to business ethics builds trust, transparency and a good reputation with all stakeholders, ranging from

customers to business partners, from regulators and governments to shareholders, and from suppliers to the communities in which an organisation operates.

Far from just giving a nice warm glow, a trusted reputation for principled business conduct delivers hard benefits to the bottom-line. There is growing evidence from organisations such as the Institute of Business Ethics that companies that have implemented codes of conduct perform better overall than those that don't.

And as codes of conduct have become the norm, further research has revealed that embedding those codes through consistent training and communication at all levels is what cements the link with enhanced financial performance.

There's a further point here. Let's be blunt: there are clear reasons why today's multinationals are subject to far more intense scrutiny over their ethics and behaviour than they were a generation ago. Not just from NGOs but from the media, the public, and increasingly politicians as well.

The landscape itself is evolving. The standards of today might not be sufficient in 10 years' time. Tomorrow's companies must not only recognise this, they must embrace it.

In such an environment, good business ethics are what give multinationals their licence to operate in each country. But in a globalised world, this becomes more complicated.

Why? Because the public perceptions of what is right and wrong in business vary between different places and are also changing all the time. Think about how the corporation tax issue has blown up in the UK in recent weeks.

What's more, companies today are expected — quite rightly — to have a public position and positive action plan on issues that weren't considered to be within the remit of business a decade ago. Things like the diversity of their workforce, climate change and the labour practices of third-party suppliers in faraway countries.

And they're expected to invest actively in the communities on which they have a business impact, including supporting social development. In emerging countries, the sheer scale of a multinational company can mean it wields huge power and influence on local society and communities which in turn brings huge responsibilities.

So, to sustain its licence to operate across different markets, a global company must adapt to a world of fragmented and shifting ethical contexts, while fulfilling its underlying responsibilities everywhere it operates. In my view, the only way to achieve this is through shared values that are applied consistently worldwide, and which are continually reinforced and improved over time throughout the organisation.

All of this boils down to two things. First, an ethical business culture is vital: there is no alternative. And second, building that culture is not a single step that can be taken and then forgotten about but an ongoing voyage where the destination is always just over the horizon.

With all those reasons for being an ethical business in mind, let me give my personal perspective on the cultural transformation at BAE Systems since I became Chairman. I hope my experiences will be valuable to other businesses considering or embarking on a similar journey.

Anyone who's been involved in driving deep cultural change in a global organisation will understand the enormity and complexity of the task. These challenges are compounded by the fact that a culture founded on responsible business conduct needs to run deep into the organisation's psyche to make a real difference.

In a multinational company, creating a new culture that sticks, and is effective not just in its home market, but internationally, means getting a number of basic structural elements right. Drawing on my own experience at BAE Systems, I'd highlight five of these.

- First, you need to ensure that the Board structure is world-class.
- Second, you need the right executive group.
- Third, you need an objective understanding of where your culture is today, and where you need to move it to tomorrow.
- Fourth, you need to embed the new culture across the business — and then sustain and grow it over time.
- And finally, you need to apply your values to forge new relationships with your important external stakeholders.

As you'll hear, these strands are all closely interwoven. Together, they can renew and reinvent the very fabric of the business. That's what's we've done at BAE Systems.

First, the Board. To be in a fit shape to plan, deliver and embed real culture change, the Board must have a world-class structure.

This demands two attributes. First, the right balance of executive and non-executive directors, which is generally accepted in the UK to be two-thirds non-executives and one-third executives. At the same time you need to ensure that the non-executives you bring in are four-square behind the culture change and that they're sufficiently robust and knowledgeable to challenge the executives as well as reflecting a diverse range of perspectives.

The second requirement — springing from the first — is that the Board as a whole must set the right overall leadership and “tone from the top”. Here, behaviour is critical. Having a Board that says one thing and is then seen to be doing another will quickly derail any culture change.

At BAE Systems, it was the balance of the Board that needed addressing. When I arrived there was a 50/50 split between executives and non-executive directors. So over the next two years we shifted the balance to 8 non-execs and 4 executives, a change that enabled us to bring in new non-executives who were not only energetic and talented, but also shared our cultural vision.

Alongside a world-class Board structure, the second priority I'd highlight for enabling culture change is getting the executive right.

This means pulling together a group of executives who are not only the most capable available, but are also fully aligned with your new values — and prepared to stand up and fight for them. A key part of getting this right is making effective use of internal talent by building a robust pipeline of future leaders who share the same ethos and culture.

Again, I can point to experiences at BAE Systems. We decided to build on our existing people appraisal processes and worked to create a stronger succession pipeline by initiating a regular independent review of the top 50 people in our company.

This assessment process has been running ever since, and is refreshed regularly now covering around 150 of our highest performers.

The first talent review in 2007 highlighted an employee called Ian King as an up-and-coming potential chief executive. Ian, as you know, is now our CEO and I understand still pays his fees as a CIMA Fellow.

As well as his outstanding leadership skills, one of the qualities that made Ian the best candidate by far, and now makes him a great CEO, is his total commitment to BAE Systems' new ethical culture.

Alongside the chief executive, another pivotal Board-level player in driving cultural change of this nature in any organisation is the General Counsel.

That same year, we were mighty lucky to find precisely such a change agent in Philip Bramwell, a former general counsel of O2, who — like Ian King — was fully behind our cultural transformation.

Having got the Board and executive right, the third prerequisite for effective culture changing is a warts-and-all assessment of your organisation's current culture and values and a clear vision of how these need to change going forward.

Different companies use different ways to gain the necessary understanding of their culture. Arguably the most effective approach — and one that growing numbers of international businesses are starting to adopt — is to commission an access-all-areas, independent review of the embedded values, culture and standards of business behaviour across the organisation.

This takes courage. And if you're really brave, you'll commit to implement the findings in full before you've even heard what they are. That's what we at BAE Systems did with the Woolf Review.

It happened like this. Back in 2006, we had the idea of asking a committee of independent experts to produce a fact-based account of our company's ethical business conduct worldwide.

Our newly-rebalanced Board gave the go-ahead unanimously. The next step was to find the best person to lead it.

When we approached the former Lord Chief Justice, Lord Harry Woolf, he initially declined saying he lacked all the attributes and knowledge we were looking for. We replied that he actually possessed the only attribute required: complete and unimpeachable integrity.

A few weeks later, after carrying out some in-depth due diligence on Board members, he agreed to take on the role. It was great news.

When we discussed the brief in detail with Lord Woolf, it emerged that he would go much further than just reviewing our ethics, using the review as an opportunity to help BAE Systems advance to the very front edge of ethical business behaviour globally among multinationals, making us the best not just in defence, but across all industries.

We liked that. And Lord Woolf followed it to the letter.

In the Blue Book that it produced at the end of the review, the Woolf Committee set a gold standard for ethical business behaviour. If you haven't read Lord Woolf's report, I would highly recommend you do!

Anyway, I'm jumping ahead. With Lord Woolf's role agreed, we helped him pull together a committee of renowned experts on business and ethics to work with him. And we underlined our confidence in the committee's findings by giving a public commitment up front, not just to publish its recommendations, but also to accept and implement them in full, whatever they might be.

When the report was published for all to see in May 2008, it contained twenty-three recommendations. Together, these provided us with a 'gold-standard' benchmark on which we could confidently reshape and rebuild our business and its culture.

This takes me neatly into the fourth theme of cultural transformation: embedding throughout the entire workforce, at all levels, and in all markets the responsible behaviour and values you've identified in your cultural assessment.

This embedding takes commitment, effort and vigilance. As I've mentioned, becoming and remaining a responsible business isn't a single step, but an iterative process. Having started the change, you need to maintain the momentum and ensure you keep it moving in the right

way. That's why you must embed not just the culture, preferably underpinned by a code of conduct, but also a continuous improvement programme to sustain and grow it by constantly monitoring progress and working out how to drive further improvement.

What was our experience? Well, when Lord Woolf published his report, we'd already said we'd implement it in full. So, being an engineering business, we built a detailed three-year process to do just that, staffed by dedicated resources from across our business.

An important milestone in this implementation process was the introduction of our new global code of conduct in early 2009 which provided all our people with practical guidance on the principles, standards and personal behaviour that they should bring to everything they do in our name.

Around the code we've created a comprehensive on-going programme of training and orientation including induction training in our values and behaviour for every new joiner, and on-going refresher training for every employee.

We don't see the behaviours that spring from our culture change programme in isolation from everything else we do. We see them as an integral part of our new business as usual: a global performance culture, encompassing not just responsible business behaviour, but safety and financial performance as well.

I'm extremely proud of the eagerness with which our employees have embraced these changes on a global scale and how they continue to push themselves to do better!

This brings me to the fifth and final strand of cultural transformation.

So far, I've focused on internal change to structures, values and behaviours. But the real impact — and acid test — of a company's culture is its impact on and alignment with the external stakeholders with whom it interacts and forms relationships. To work well and create the most value, these relationships need to be based on mutual values, trust and openness.

Again, let me draw on our experience at BAE Systems. A multinational company like ours has a multiplicity of stakeholder relationships worldwide. So I'd like to focus on two of our most important: regulators and major customers.

Of course, by 'regulators' I'm mainly referring to the investigations initiated by the UK Serious Fraud Office in 2004, and by the US Department of Justice in 2007, into some of our legacy business dealings in the 1980s and 1990s.

Let me be clear. The investigations focused on very serious issues. We regret — and accept full responsibility for — the past shortcomings that the authorities investigated. But, in the past is what they are springing from a time when we were a very different business than we are today. No one can change the past, what everyone can do though, and what we believe we have done at BAE Systems, is build a better future.

The settlement enabled us to draw a line under those historical issues. But crucially, it also did much more by allowing us to lay down a bedrock of trust and transparency on which to build stronger and more open relationships with the regulators concerned.

With the SFO, we became actively involved in shaping the UK Bribery Act, a piece of legislation that we wholeheartedly support, and which is now the main legislative tool through which the UK ensures effective corporate compliance with ethical standards.

At the same time, under the settlement, the US DoJ and Department of State appointed independent Monitors to scrutinise our business practices and recommend improvements.

When this arrangement was agreed, we had little idea how much it would help us drive our ethical transformation forward. But it really has.

The Department of State's monitor has provided us with valuable technical input around our compliance with the US's International Traffic in Arms Regulations.

Meanwhile the DoJ's monitor, Lord Gold, has done a thorough job of reviewing and evaluating the effectiveness of our internal controls, policies and procedures for complying with our principles of business conduct.

In doing so, he's come up with a host of hugely valuable recommendations that we've acted on. Sadly, his term as the DoJ's monitor is likely to end later this year. We'll miss him, and our Board is now looking at how best we can carry on his good work.

The fact that Lord Gold's contribution actually sprang from the DoJ reflects the way our transformed culture has in turn enabled us to transform our relationships with regulators.

It's also helped us elevate our customer relationships to a new level of trust and openness.

The week before I joined, there was an almighty public bust-up between BAE Systems and the UK Government over a number of projects. Today, after a decade of culture change and positive engagement, our relationship with the British Government is totally different.

An example of this is that both the current Prime Minister and also the last one invited me to join their respective business advisory groups.

Looking more widely at our customer relationships across the world, one of the most important steps we've taken was our decision in 2007 — before the Woolf review — to rewrite the contracts for all our third-party advisers worldwide and submit each of them to a new and more rigorous approval process, including scrutiny by external lawyers.

This process is still in place and it's so demanding that it's very difficult for anyone to get through it. Which is how we like it. When Lord Woolf published his report, he said this process was already leading-edge in managing ethical and reputational risks.

However, when we introduced our new adviser process, the received wisdom across the global defence and aerospace industry was that we'd seriously shot ourselves in the foot and that we would simply stop winning contracts in many countries. This view was reinforced by the fact that we now actively turn down projects if we think they might cause us to contravene our ethical code.

In practice, what looked to many like an albatross around our necks has turned out to be big winner with customers across the world who positively want to deal with providers who behave ethically. This year, our order book outside the US and UK is twice the size of a year ago.

We're winning more business. And we're doing it in our own way, and on our own terms.

You'll want to ask questions. So allow me to gather some threads.

I said at the beginning that there are seismic changes under way in how the free enterprise system is working.

To illustrate these changes, I've talked about the pivotal importance of values — and of how we transformed our values at BAE Systems. And I've discussed how the structure of the Board and the executive team are critical to continued success.

I've also described how we embedded our new values, not just in the UK but internationally, with the result today that we have a consistent culture and way of behaving everywhere we operate.

And I've talked about how we drew a line under the past.

However, our goal is not to live in — or dwell on — the past but to shape the future. Our licence to do that ultimately turns on our contribution — and the value that we bring — to society.

To end on a personal note, of all the aspects of being Chairman of BAE Systems, I feel the most important is our collective role in realising human potential and creating value through ideas.

I'm an engineer. And I've been hugely fortunate to have the opportunity to support the renaissance of engineering in the UK. BAE Systems employs 18,000 qualified engineers in this country, more than any other business. And we're a British company at the forefront of global innovation and technology at the highest level — pioneering the frontiers not only of our long-standing business areas, but also new vistas of opportunity like intelligence and cyber security.

Tomorrow's companies will be agile. They'll be principled. And they'll be innovative. At BAE Systems, our goal is to build one of tomorrow's companies, a global leader well into the future. And I hope that the experiences I've shared of how we moved from the past to the present will be relevant to other companies undertaking the same journey.

Thank you.