Carillion:

A Salutary Study in Corporate Values

The collapse of the construction company Carillion in 2018 sent shock-waves through the UK. Its behaviour was clearly at variance with its stated corporate values. ***Richard Higginson*** *– with valued insights from Cal Bailey – explores what lessons can be learned from this sorry tale.*

Values statements are standard fare for most self-respecting companies these days. They express laudable ideals, and are sometimes articulated in snappy corporate logos or are backed up by substantial ethical codes. But do these oft-repeated fine words have any basis in corporate behaviour? Do they actually stand the company in good stead or provide a sure guide to behaviour when the going gets tough?

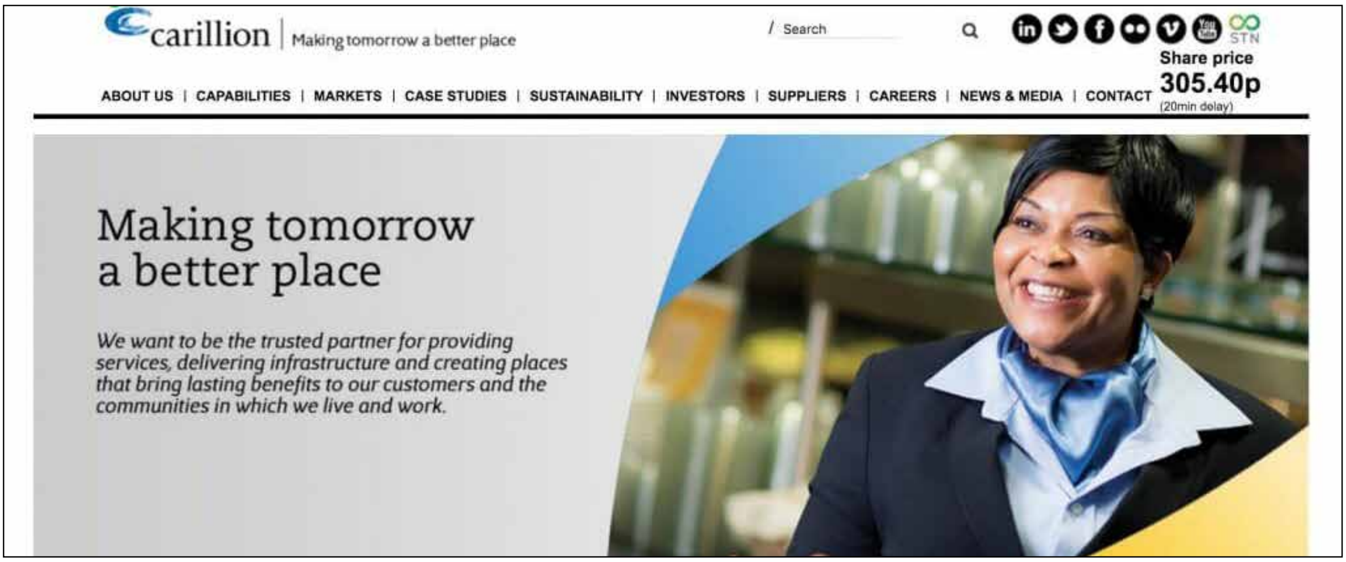
That is the disturbing question raised by the story of Carillion, the major international construction and facilities management company which collapsed in 2018. The reasons for this failure were thoroughly investigated by a parliamentary inquiry which reported in May of that year[1]. In particular they were extremely critical of many different parties – the CEO, CFO, Chairman, board, auditors and regulatory authorities. While this article will make reference to these failings, its principal focus is to explore something the parliamentary report ignored - what went on and what went wrong at the values level.

Good Times

Carillion was formed in 1999 out of a coming together between Tarmac and Wimpey, two construction and house-building companies, which then moved in different directions. Taylor Wimpey has become a successful house-building company. The construction business became a separate plc with a new name – Carillion.

Carillion's initial Chief Executive was Sir Neville Simms and he was succeeded in 2001 by John McDonough. Both men put high store by corporate values. The specific values of Carillion that were articulated on their corporate website were openness, collaboration, mutual dependency, professional delivery, innovation and integrity. These values appear to have influenced the Chief Executives' own behaviour, were deliberately applied to corporate activity, and were understood and accepted by the wider Carillion team. A test of corporate values often occurs when takeovers or mergers take place. Two major acquisitions – those of Mowlem and Alfred McAlpine – took place without any apparent dilution of the values. Employees of Carillion and their new colleagues worked together to implement them.

Throughout Carillion's life, the government was the company's largest customer. It successfully landed many major public sector contracts, notably in the building of hospitals, roads and schools. At the time John McDonough retired as Chief Executive in 2012, the company's fortunes appeared to be thriving. This was reflected in its high share price.



Decline

Things started to unravel after 2012, though for a time this wasn't obvious. McDonough had brought in a new Chief Finance Officer (CFO), Richard Adam, who was brilliant with numbers and highly focussed. McDonough himself was succeeded as Chief Executive by Richard Howson, an internal appointment. Both Howson and Adam were familiar with the values approach, but it is clear that it was not so central to how they operated as had previously been the case. In addition, the company started to come under greater pressure as the full impact of the 2007-9 recession worked through – construction projects often taking several years to complete. When projects persistently exceed budget and results do not turn out as hoped, a business's commitment to its values of openness and collaboration becomes a real test. Another major construction company, Balfour Beatty, also experienced serious difficulties during the same period, but was much more open about them. This actually triggered a takeover bid from Carillion which was rebuffed; it failed to win approval from Balfour shareholders.

With regard to Carillion's stated value of integrity, it is important to note its meaning to accountants: integrity conveys the idea of honest and consistent financial reporting. Such a view is understood by all the bodies of chartered accountants in the UK. Integrity in its financial context specifically includes avoidance of misrepresentation.

It became clear at the parliamentary inquiry that over the period 2012-17 the corporate figures had been massaged. On the surface, Carillion continued to appear a successful company, with handsome executive bonuses and continuously rising dividends for a further four years until the December 2016 year-end. The accounts published in May 2017 received unreserved approval. Experts tell me this is less difficult to secure in a construction business than it would be in manufacturing: long-term contracts present considerable opportunity for aggressive accounting, because predicted profit on end-of-contract forecasts can be difficult for auditors to judge. Carillion continued to maintain what looked like a healthy cash balance through a mixture of borrowing, failing to fund its pensions properly and the practice of late payments to suppliers – something for which the company had a bad reputation.

This state of deceit could not go on indefinitely. During 2017, three profit warnings were issued. Additionally, it became visibly evident that certain contract profit forecasts were mistaken when cracks literally appeared in the Royal Liverpool University Hospital, a very large PFI (private finance initiative) contract.

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Richard Adam, the CFO, had retired in 2016, taking a bonus and cashing in his substantial share options immediately. Richard Howson resigned as CEO in July 2017. A new CFO tried to raise money, but was unable to do so. The company's demise was swift. Administrators couldn't be found, and liquidators were appointed in January 2018.

The consequences of Carillion's collapse were deadly serious. £7 billion of debts were owed to around 30,000 suppliers, banks and pensioners. One family business which was a notable Carillion supplier, NG Bailey, lost £2.2m. Carillion's is the largest liquidation of a trading UK plc in history. The company employed over 40,000 people. Some remained with their contracts as they were re-assigned to different employers; many others were made redundant. Hundreds of small, medium and large businesses failed in consequence. So much for the 'mutual dependency' expressed in the corporate values statement.

Responsibility

Apart from the CEO and the CFO, the Government has been blamed for Carillion's downfall, because it kept placing contracts with the company with bids that were unrealistically low. Should it not have realised Carillion was in trouble and unable to deliver? Possibly, but it needs to be recognised that it wasn't until early 2017 that it was public knowledge Carillion was in difficulties, and the government may have lacked the requisite information.

This shifts attention to the Board and its auditors. KPMG, one of the big four UK audit firms, audited Carillion for many years out of its Birmingham office. Audits carry a duty to ensure assets and liabilities are fairly assessed and accurately stated, and to assess the likelihood that the business can continue 'as a going concern' for the foreseeable future.

It appears that the commercial relationship between auditor and management was too close – that is, each depended on the other too much – and the critical distance needed for an objective audit was insufficient. In such circumstances, it is difficult for the auditor to be persistent in asking awkward questions. What transpired was that the audit failed to expose publicly in its annual report what is likely to have been a major private concern to the auditors involved. This episode, along with other cases of corporate collapse, underlines the need for the accountancy profession to reconsider processes for ensuring proper independence, objectivity and competence.

The primary responsibility, however, for ensuring that financial statements are not misleading and that the business is solvent, lies with a company's Board of Directors, and especially its Audit

Committee. Here too there seem to have been significant failings. From 2014 Carillion's chairman was Philip Nevill Green, not the Philip Green of Arcadia fame but an experienced businessman known to be a practising Christian. He was criticised by the parliamentary inquiry for being an 'unquestioning optimist', but it appears that he recognised there was a problem, because the Board created a Values Sub-Committee to ensure the company's stated values remained embedded in Carillion's behaviour. However, this had little effect, or perhaps it happened too late.

Carillion's statement of values recognised that the company had a responsibility to all its corporate stakeholders, notably the suppliers who relied so heavily on its business. But the evidence suggests that the Board were focussed on only one of the stakeholders – the shareholders, who included most of the senior executives – to the neglect of the others. Hence the consistent concern to boost dividends when the financial state of the company did not justify this. Perhaps the directors intended to come back to the values they espoused when the situation allowed, but it never did. The biblical notion of idolatry is relevant here. Idols have a way of demanding more and more from us, until we are thoroughly seduced by their sway and end up exhausted.

Hollowed Out Values

The cynic will say that Carillion's allegiance to the fine values it articulated was merely lip-service. That may be true, but I suspect the reality is more subtle. The CEO and CFO probably thought they believed in them, but when the business climate got tough (as it did from 2012 onwards) their attention shifted elsewhere. The CFO was expected to continue producing numbers which were good news, and – determined as ever – deliver them he did, until he retired and was gone. The CEO colluded with him in this.

The real cause of the collapse is that the values at Carillion were 'hollowed out'. In saying this I am aware that we all make mistakes, in all walks of life, especially when the pressure is intense; and it is easy to be critical from outside. Christian humility compels us to say: 'There but for the grace of God go I'. But the Bible contains some searching critiques of values that had become hollow. We see this both in the Old Testament and the New. In Isaiah 58 God lambasts his people for empty fasting rituals combined with exploitation of workers and a shameless 'serving their own interests' (vs 3, 13). In Matthew 23, Jesus' diatribe against the scribes and Pharisees, he castigates them for being 'whitewashed tombs' and neglecting the 'weightier matters of the law' - justice, mercy and faithfulness, qualities worthy of any values statement.

The Carillion values weren't explicitly abandoned; they remained visible on notice boards and websites and on the lips of some managers. Ironically, the corporate values could still be found on the corporate website a full year after the company collapsed. Nobody had bothered to take them down. But they ceased to be practised by a Board that was no longer presiding over a financially sound business.

Cal Bailey, former Sustainability Director at NG Bailey, one of the suppliers that suffered through Carillion's demise, makes a telling comment. He says that NG Bailey had a saying in their business: "Values must be lived, not laminated." How true that is. Cal also points out that it is real engineering which generates wealth, not financial engineering or aggressive accounting. The latter can only be used to conceal poor performance temporarily. Financial engineering can become a fig leaf for the truth, a deceiver.

This is why values are so important – they tell us what we should do. Values which are well thought out and expressed act as the corporate conscience. For a Christian, of course, they don't have the same authority as the ten commandments or the teaching of Jesus. But in an increasingly secular and multi-cultural society values often seem to be the closest approximation we can get to Christian teaching that can command general agreement.

In the case of Carillion, values became the neglected nagging voice which foretold a tragedy. With so many companies under severe pressure as a result of the Covid pandemic, the temptation to go down the direction pursued by Howson and Adam could be a serious one. The lesson that the Carillion debacle teaches us is that it should be firmly resisted.

1. See https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/769/76902.htm

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