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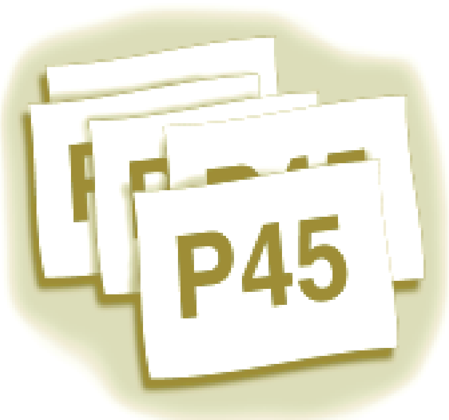
The practical problems of downsizing



Justinia Lewis on the implications of making people redundant

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THE NEW AGE

Where finance and personnel meet

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Faculty faces

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Where to find useful HR advice on the web

These web sites may be useful for readers interested in human resource issues:

Federation of European Employers – provides a range of free resources and links to HR resources for Europe, including 'Pay and working conditions across Europe 2000' as well as an HR bookshop. Users can also subscribe to the European Personnel Resource Centre, which includes current 'data designed specifically for the HR practitioner operating in a pan-European enterprise'.
www.euen.co.uk

HR Now – impressive web site aimed at providing personnel and payroll professionals with 'topical advice, alerting and reference service', including quick guides, an employment legislation service, a comprehensive set of HR links, and a newsfeed.
www.hr-now.co.uk

HR Zone – described as an on-line community for HR professionals, available free after registering, this includes news, features, links, reviews, a forum for HR issues, and expert answers.
www.hrzone.co.uk

OneClickHR – commercial web site with a range of services, including information on HR software, news, an update service, and an employer's guide. Free registration for access.
www.oneclickhr.com

PersonnelToday.com – useful resource for HR professionals which includes a news feed updated throughout the day, a directory of HR specialists and consultants, a search function (for articles in related publications since January 2000), and a Yardstick service with a regularly updated listing of key workplace indicators.
www.personneltoday.com

More human resources links are available from the ICAEW web site's links pages at: www.icaew.co.uk/library.htm

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Comments and suggestions should be addressed to Chris Jackson BA FCA, Head of the Faculty (see left).

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ABSTRACTS FROM LIBCAT

Child J – The management of international acquisitions
Oxford: Oxford University Press, 2001
● *Issues concerning post-acquisition performance and the changes in management practice introduced by acquirers of different nationality provide the focus of this book. Chapters include: introduction; acquisitions in a globally competitive landscape; post-acquisition performance and management; theoretical perspectives; national management practices; scope and methods; trends in post-acquisition management; integration and control; integration – a closer look; processes of post-acquisition change; human resource management; performance after acquisition; national case studies from the USA, Japan, France and Germany; and conclusion.*

Smith I – Growing a private company – commercial strategies for building a business worth millions
London: Kogan Page, 2001
● *Aimed at owners of private companies who have hit problems and require support and good advice, as well as entrepreneurial companies who are not fulfilling their potential. Chapters cover: strategic analysis; business operations; growth techniques; raising finance; acquisitions; and exit options. The appendices contain: commercial due diligence, long form due diligence report, post-acquisition and joint venture checklists; and listing requirements. Bibliography, useful internet addresses and information sources, case studies, models and tables.*

Exten-Wright J – Adverse conditions and employment law
Tolley's Practical Audit and Accounting, Vol.12. No.8. May 2001: p85-87 (3 pages)
Signs of a 'slow-down' may cause employers to focus on payroll costs. This article explores legal options. Covers wage reduction, removal of bonuses/performance payments, lay off/short time working, and redundancy.

http://www.icaew.co.uk/library.htm

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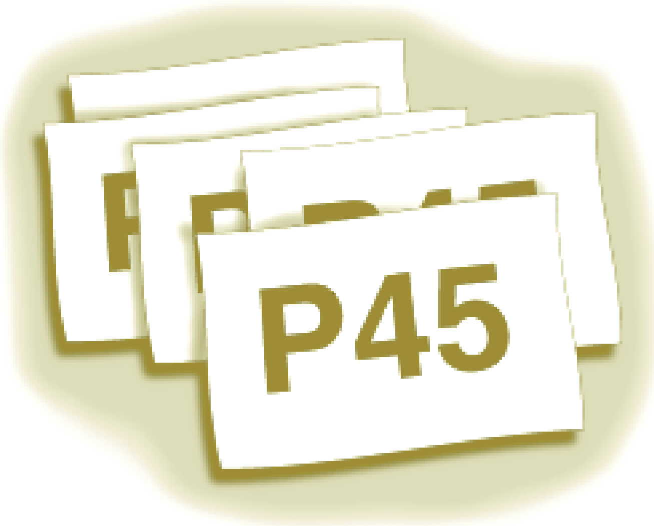
The practical problems of downsizing



The spectre of economic downturn means that, sadly, business closures and redundancies are becoming more frequent. **Justinia Lewis**, an associate at international law firm DLA, describes the legal requirements for procedures with which no-one would wish to be too familiar.

Whilst a decision to close a business or to downsize is never taken lightly, many employers are unaware of the potential pitfalls in failing to comply with complex legal requirements on redundancies, which can result in expensive legal claims from employees.

In addition, the fairly recent announcements of job losses at Corus, Rover and Vauxhall were accompanied by public criticism that employees had been given no information or warning. If employers want to win the public relations war, as well as minimising legal risk, careful advance planning of a redundancy programme, and a considered consultation and information exercise, is the key. This article sets out a brief outline of the main issues to consider when planning redundancy. However, redundancy is a tricky matter from a legal perspective, and proper advice should always be sought.

Legal obligations

A potential redundancy situation may arise because of a decision to close a business, or to cut the workforce. This triggers a number of legal obligations:

- selecting employees for redundancy on a fair basis;
- considering suitable alternative employment;
- paying redundancy payments;
- giving employees proper notice of termination of their employment;
- consulting with individual employees;
- consulting collectively; and
- notifying the DTI.

Consultation – a first step

The most commonly neglected step in redundancy exercises is consultation – and the potential costs of this failure can be significant. Individual redundancies can be unfair because of a lack of consultation, with potential maximum compensation of £51,700. In relation to large scale redundancy exercises, a failure to consult with recognised unions or employee representatives can result in protective awards of up to 13 weeks' pay for each employee. Consultation must take place when redundancy proposals are first proposed and before anything is formally decided.

Collective consultation

If an employer wishes to make 20 to 99 employees redundant in a period of 30 days or less, it must consult on a collective basis regarding the redundancies for at least 30 days. For 100 or more redundancies, collective consultation must go on for at least 90 days.

Collective consultation should be with trade union representatives (if unions are recognised) or with elected representatives of the employees if there are no recognised unions. Non-unionised employers should bear in mind that it may take some time to arrange elections before the 30 or 90 day periods can begin.

Consultation should begin when the employer has 'proposals' to make redundancies – employers should therefore not delay in starting consultation. Before consultation commences, the employer is obliged to provide certain information including, the reason and number for the proposed redundancies, the proposed methods of selection, the proposed methods of carrying out the dismissals and the proposed date of the dismissals. Consultation should include ways of avoiding dismissals, reducing the numbers to be dismissed and mitigating the consequences of dismissals. Consultation should be carried out 'with a view to reaching agreement' although there is no obligation to do so. If the representatives put forward any alternative proposals, the employer must give reasons for rejecting those proposals.

'Individual consultation allows employees to mention any relevant factors and to air any grievances about their redundancy... '

Individual consultation

Employers should consult each employee who is potentially redundant on an individual basis and give consideration to their views. Individual consultation allows employees to mention any relevant factors and to air any grievances about their redundancy. As with collective consultation, individual consultation must take place before any redundancies are announced, or an employee can complain that it is a waste of time. However, there is no fixed minimum period.

Informing the DTI

An employer must notify the DTI on Form HR1 of proposed redundancies involving 20 or more employees. The time limits are the same as for starting collective consultation and failure to comply can lead to a £5,000 fine.

Carrying out a fair redundancy process

Redundancy is a potentially fair reason for dismissing employees. However, an employer must still show that the employee is genuinely redundant, and that he has acted reasonably in order for the dismissal to be fair. Otherwise, employers may receive claims for unfair dismissal, resulting in potential compensation of up to £51,700 per employee. There are a number of aspects of carrying out a fair redundancy, in addition to the consultation obligations set out above.

Fair selection of redundancies

If the redundancy plan is to reduce the workforce rather than completely close a business, employers must consider how they should select redundant employees. First, an employer has to decide the groups from which employees will be selected for redundancy. Second, the employer must apply fair selection criteria for deciding which employees should go. An employer has a free rein in choosing the selection criteria, but it is essential that these are relevant, reasonable, objective and were applied honestly and without discrimination. Criteria such as attendance record, length of service, skills, competences and disciplinary records are commonly used.

Singling out part-timers for redundancy is unlawful under new protection for part-timers. Employers should think about whether poor scores under categories such as attendance or performance are linked to any protected condition such as disability or pregnancy. Redundancy selection for trade union membership grounds is automatically unfair.

Another problem arises where redundancies are connected with the transfer or sale of a business. Such dismissals will automatically be unfair, unless the dismissal is for an economic, technical or organisational reason entailing changes in the work-force. This is a very tricky area and employers should always take legal advice to avoid significant liabilities.

Considering alternative employment

Employers must consider whether there are alternative jobs for redundant employees, including in other group companies.

Employers should not assume that an employee will not be prepared to move to take a new job, or take a job at lower pay or status. The individual consultation process provides a good opportunity to discuss alternative posts. If an employee refuses to accept a suitable post of alternative employment unreasonably, the employee concerned may not be entitled to a redundancy payment. The employee has a four week trial period in any alternative post.

The obligation to make payments to redundant employees

The cost of redundancy payments and notice pay must be factored into all redundancy plans. An employee is only entitled to a redundancy payment if he has had at least two years' continuous service since the age of 18 and is under 65. Redundancy payments are calculated according to length of continuous employment, the age of the employee and the weekly rate of pay subject to a statutory limit, currently £240. There is also a cap on the maximum number of years' continuous service which can be counted, currently 20.

The formula is:

- for each complete year of continuous service between the ages of 18 and 21, half a week's pay;
- for each complete year of continuous service between the ages of 22 and 40, one week's pay; and
- for each complete year of continuous service between the ages of 41 and 65, one and a half weeks' pay.

The current maximum entitlement is £7,200. However, many employers operate enhanced redundancy payment schemes which entitle employees to considerably higher amounts, so this should always be checked when the potential costs of a redundancy exercise are calculated. In addition to redundancy payments, an employer is also obliged to pay the employees for any holiday entitlement which has not been taken at the time of termination, and to provide contractual pay and benefits for the notice period.

Following the redundancy decision

Once redundancies have been announced and the redundant employees given notice, employers must be prepared to contend with resentful and demotivated employees. Treating redundant employees as fairly as possible is likely to improve the moral of employees who are staying as well as those leaving. Employers should offer employees who have been made redundant reasonable paid time off for job hunting and training. In addition, there are a number of other support mechanisms which can be put in place, for example outplacement counselling, help with CVs and job applications, provision of information about recruitment agencies, and liaising with the local job centre.

Employers may not want redundant employees to work out their notice period, and prefer to pay them in lieu of notice. The employer may be able to pay some or all of their notice pay tax free. If employers need the redundant employees until the end of their notice period, they should remember that employees may be entitled to leave early to take another job, without losing their entitlement to a redundancy payment. Termination bonuses may ensure productive work until the end.

A European perspective

Employers with a pan-European or international presence should be even more careful about redundancies. Many European legal jurisdictions have extensive requirements, involving obligations to agree redundancy plans with unions, and significant financial payments. Redundancy in the UK can look relatively cheap and simple compared with many European countries. Employers in Europe may also be obliged to consult with a European Works Council about redundancies – or risk a penalty of up to £75,000.

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Putting 'post-acquisition' into context

Under the expert guidance of **Mary Moore** of the Business Learning Partnership, and consultant **Ian Shortland**, Faculty members who attended this summer lecture learned how to handle the all-important post-acquisition phase of any deal.

The June 'Post-acquisition in context' workshop was a fascinating insight into how to handle the real issues arising from a takeover or merger, once the transitory 'high' of clinching the deal has faded.

As Mary Moore of the Business Learning Partnership observed, the question of integration should ideally be considered during the acquisition process – but often isn't. Post acquisition, then – though lacking glamour – is the part determining whether a deal succeeds or fails.

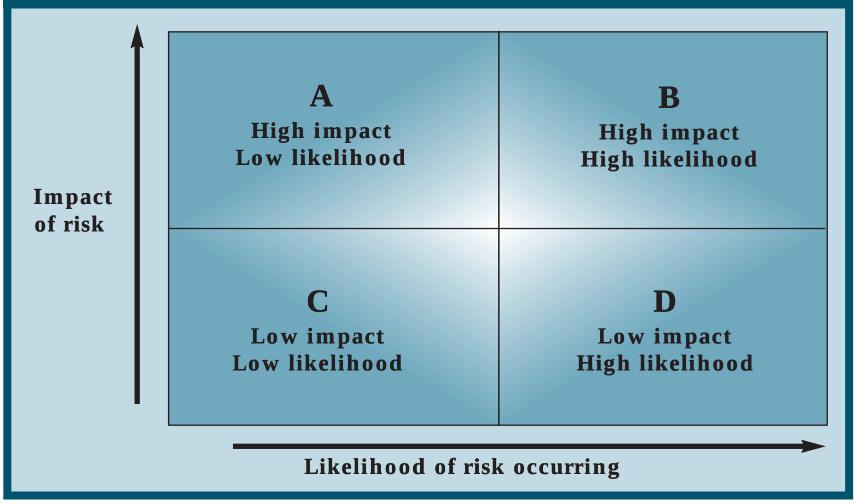
To put this 'delivery' issue into context, Moore indicated the six distinct stages in which the acquisition process should ideally be conducted:

- develop a strategy;
- identify and approach the target;
- perform the due diligence;
- price the deal;
- do the deal; and
- combine the businesses.

The important factors are whether an acquisition will bring real expansion, market strength, synergies, quick market entry, new competences, or add value. Identifying the target should be akin to house-hunting – agreeing an ideal set of criteria for the target, ranking them in importance, and deciding which can be compromised on and which are deal-breakers.

In approaching the target, many companies prefer to send their own representative(s), rather than adviser(s), as the first encounter provides an early

FIGURE 1 RISK ANALYSIS



'feel' for compatibility levels. At this stage a confidentiality agreement is usually asked for by the bidder, and the biddee will ask for an indicative bid before agreeing to due diligence.

Due diligence is a financial, legal and commercial exercise to unearth – much as in a house survey – issues (whether risk or opportunity) affecting the deal. Since it is time-constrained and expensive, Moore suggested taking a risk-based approach, placing the most important areas on the risk analysis grid (*Figure 1, see previous page*). The results can then be used for negotiating on price.

Moore stressed that the commercial assessment within this stage is surprisingly qualitative, involving such elements as trends, brands, market mind-set, marketing orientation and the whole marketing chain.

Customer analysis is also important in due diligence. Where buyer and target have common customers it is important to assess the likely sales losses (perhaps of customers with a multi-supplier policy) or gains (eg by bundling products). Where each has different customers, what are the prospects for cross-selling? Also, what could the combined operation offer to a new breed of customer?

Pricing the deal

Pricing the deal is always tricky. Many acquisitions have looked over-priced, or lacking in the promised synergies, when the buyer later writes off a large amount of goodwill. However, Moore pointed out that part of this is a result of the buyer having to 'give away' some of the synergy benefits of the deal to the target. If the anticipated synergy is not completely realised, the shortfall makes a considerable dent in the bidder's balance sheet.

Doing the deal

This means deciding whether you are buying assets or equity, and whether you are paying in cash or equity or a mix. Paying in equity is becoming more popular (50% of 1998 deals were equity-only, against 2% in 1991). And for 'new economy' deals, equity is all the company may have. There again, a cash deal means that although the bidder takes all the risk, it also enjoys 100% of synergy benefits. At this stage, lawyers will be directly involved.

FIGURE 2 SETTING PRIORITIES

	Low integration risk	High integration risk
High savings and synergy	**Do it!**	**Study it!**
Low savings and synergy	**Get around it!**	**Forget it!**

Integration

This is where the hard work begins. A blueprint for the integration strategy should be delivered to employees as soon as possible, by a heavyweight person (internal or external) who ideally was involved even before the deal. There may well be problems, especially at the top, when two former competitors are suddenly expected to live happily as one.

There are five possible strategies:

- *absorption* – the bought company transforms into the style of the buyer;
- *preservation* – the acquired company retains its independence;
- *transformation* – both companies find new ways of operating;
- *reverse merger* – the acquired company dictates the terms for the merged operation; and
- *best of both* – the new modus operandi takes the best elements from both sides.

Once a strategy has been chosen, the priorities for action need to be identified, and this can again be done on a grid (*see Figure 2, above*) of savings/synergy against integration risk. As the figure shows, some things will not merit action, given their high risk and low savings/synergy benefits.

In summary, Moore emphasised the importance of communication, of being realistic in estimating synergy value, of being prepared to walk away from a deal, and of starting the post-acquisition integration planning even before the deal is done.

Case study – post-acquisition integration in practice

Following this comprehensive checklist, Ian Shortland of Shortland Consulting presented a case study relating to a £50 million recruitment business owned by a FTSE 100 company to which he had recently been seconded as an interim board director responsible for managing the post-acquisition integration. First, ground rules were established:

- the interests of the parent organisation will be considered before individual/personal interests;
- commercial decisions must satisfy the premise that profitability of the combined business is at least equal to the sum of the parts;
- decisions and discussions will be handled with integrity, openness, and honesty;
- difficult decisions will not be avoided;
- we aim to create one business within the parent culture while recognising the need for flexibility in local markets; and
- at all times we must remember that we have a business to run and targets that need to be achieved.

Most importantly, he said, those handling the integration were aware of the need for clarity of direction and supported this through structured management tools and approaches, clear issue identification, and empowerment to plan and implement.

The integration team quickly established an integration plan, in terms of immediate and short-term challenges to the business, including:

- immediate challenges (completed within four weeks):

  — change staff attitudes;
  — review the approach to the market;
  — reorganise for optimum service and future growth;
  — manage customer expectations and inspire confidence; and
  — ensure accurate management information systems, payroll and commission; and

- short-term challenges (completed within nine weeks):

  — move from the previous individual corporate identities to a common one – eg, how and when to rebrand products, and whether to do so under the parent brand, or an altogether new one;
  — establish a financial budget supported by an operational implementation plan; and
  — use those plans and budget to develop a robust business plan.

Delivering the plan

Shortland stressed that, in post-acquisition integration, it is key to:

- ensure that clarity of objectives is clearly communicated from the CEO to all front-line managers;
- use a structured approach to managing the integration which is owned by the management team and where: (a) planning is democratic, and signed off by the board; and (b) execution is autocratic;
- create an atmosphere of openness and honesty, with ground rules;
- confirm and implement the organisation's structure fast, with clear accountability;
- ensure a consistent message to customers, involving them in the process as much as possible; and
- if possible, include the management team in the due diligence process.

Mary Moore, a chartered accountant, is a founding member of Business Learning Partnership Ltd. Tel: 020 77994 7524; email: mary@businesslearning.co.uk.

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The benefits of real options (part 2)

In his second article on real options, **Tom Copeland** explains different types of options, giving case studies of how their use in real option analysis has changed specific decisions.

Modern option pricing was kick-started by the 1973 paper by Fisher Black and Myron Scholes, and the synchronous work of Robert Merton.

Scholes and Merton won the Nobel Prize in Economics for their groundbreaking work. However, the seminal Black-Scholes option pricing equation values the simplest of all financial options – a European 'call' that can be exercised only on its maturity date, has a constant exercise price, and is contingent on an underlying security that has constant variability (from a single source) and pays no cash flows (nor receives any cash inflows).

Practitioners of real options need to – and now can – handle much more complicated assumptions. For example, a research and development programme typically is a compound option contingent on an underlying asset (the value of a cure) that is driven by multiple sources of uncertainty – a 'compound rainbow' option. Often it has both cash outflows and inflows, has changing exercise prices, and may have changing risk.

Of the different flavours or types of real option that exist, the four examples set out here and on page 8 show real-life solutions.

❶ Put option

A put option is the right to sell at a predetermined price. Abandonment options and options to scale down a project are put options. So, too, is the cancellation feature in an operating lease, because the leased equipment will be returned and the lease cancelled when the value from operating the equipment falls below the value of the lease payments.

In this example, the company was a manufacturer of jet engines. In that industry, competition to get your engines onto the wings of an aircraft is intense because once there, the engine generates demand for a 30-year stream of spare parts. To win a contract, manufacturers of jet engines finance the purchase of the aircraft then lease it to the airline. Furthermore, the lease will be cancellable at the option of the airline starting a few months prior to delivery and extending to a year after delivery. When we valued the cancellation put option, it turned out to be 83% of the value of the engines on narrow body aircraft, but the company's CFO felt unable to stop offering the cancellation clause, for fear of defections to competitors still providing that option.

We suggested that the value of the option to airlines differed as according to the variability in their passenger revenue miles, being worth more to those with greater volatility because they were more likely to exercise it. Therefore, we did a market segmentation analysis based on variability.

More companies are adopting real options because the logic for capturing the value of flexibility is compelling, because applications methods are able to handle the complexity, and because they are understandable. Expect to see a rapidly growing number of applications, and expect to see graduate schools of business giving much more comprehensive coverage of the subject.

Tom Copeland is managing director of the Corporate Finance Monitor Group in Cambridge, Massachusetts.

'Real Options: A Practitioner's Guide', is co-authored by Tom Copeland and Vladimir Antikarov and published by Texere, of New York and London, priced at £35. Tel: 020 7204 3644 or visit: www.etexere.com/realoptions.

❷ Compound option

Often you can undertake a project in phases, after each phase having the option to stop or defer. Hence each phase is an option contingent on the earlier exercise of another option (or options). Such options-on-options are compound options.

Example: a large chemical company had just finished a net present value (NPV) analysis of a new large plant that would cost $650 million for construction over a two year period. Its output was to be a commodity chemical and the spread between the price of the output and the cost of the input chemicals was highly cyclical. It was currently mid cycle. A NPV base case, using this mid cycle spread, had a negative NPV of roughly $70 million – about 10% of the total investment outlay. Scenario analysis was not particularly insightful because it showed a very high NPV when spreads were high, and a very low NPV when spreads were low. This situation could, however, be examined as a compound option because, rather than pre-committing to all phases of construction, the company could spend $50 million on a design phase, then abandon the project if the spread had worsened by then, or it could abandon at the end of a pre-construction phase that cost an additional $250 million.

❸ Deferral and learning options

A deferral option is the right, but not the obligation, to invest in the start up of a project at a later date. One of the tricky aspects of deferral options is that unless the value of the underlying asset deteriorates – because it pays out cash flows, eg dividends, or because competition moves first – it always pays to keep your options open, or to defer.

But companies don't usually defer. One explanation is that deferral options are often combined with learning options. For example, in deciding to open a gold mine one source of uncertainty is the price of gold in the future. However, a second uncertainty – the quantity of gold in the mine – is reduced only by opening the mine; it is therefore a learning option. Mines often open immediately, because the value of exercising the learning option exceeds the value of deferring.

In a real example, a company was bidding against others for the right to develop a coal mining property. Standard NPV analysis was based on extrapolation of the growth in the price of coal, less expected extraction costs. The resulting cash flows were discounted at the cost of capital, and finally the cost of developing the mine was subtracted. The resulting NPV, $59 million, seemed too low, and there were rumours of more competitive bids. Upon reflection, the company realised that the lease contract from the government would give the right, but not the obligation, to develop the mine any time during the next five years. After the five-year limit, the lease would revert to the government. Therefore, the winning bid effectively included a valuable deferral option that could not be taken away by competition.

This option was especially valuable as the market price per ton of coal then was only one dollar above the extraction cost, hence a one dollar price shift would either wipe out all profits or double them. Therefore as a deferral option, which would be exercised by spending money to develop the mine (the exercise price), the project was worth an additional $65 million beyond the NPV. The company won the bidding, the price of coal went up, and the mine was opened. By the end of the 1990's the value of the mine was nearly $1 billion.

❹ Switching option

Switching options provide the right to change the mode of operation by paying a switching cost.

The most interesting example we worked on was in the consumer personal computer assembly business. At that time most competitors were not earning their cost of capital (with the exception of Gateway and Dell), yet the demand was growing at double digit rates. The question before management was whether to shut down the plant with the hope of opening it again at a later date or to exit for ever.

Since the company had negative cash flow, this amounted to figuring out how long to continue to lose money (in the hope that prices would rise) before getting out. If switching costs are large, it is rational to stay open making losses, until the present value of expected losses equals the cost of shutting down. ROA not only provided an estimate of the value of the business, but also indicated when to shut down, when to reopen, and when to abandon.

FINANCIAL REPORTING
UPDATE

Changing to IAS

By 2005 listed companies will need to have moved towards adopting International Accounting Standards (IAS). **David Chopping** looks at what this is likely to involve.

David Chopping is the technical partner of Moore Stephens, London. He is a member of the technical and practical auditing committee of the Audit and Assurance Faculty.

The European Union has already announced that listed companies will need to move towards the use of International Accounting Standards (IAS) by 2005. However, the details of the changes have yet to be agreed.

There is also the question of whether it will continue to make sense to have national standards, and standard-setting bodies, for private and unlisted companies. It would seem much more practical to make a complete move to IAS, rather than have very different bases for listed and other companies. This is also being considered.

Whatever the detail of the changes, this move will have a major impact. While convergence of accounting rules has been ongoing for some years, there are still various areas of difference.

Financial instruments

An obvious current area of difference is that of financial instruments. Current UK guidance deals with capital instruments as regards the liability or equity side, but does not really deal with financial instruments as assets. There is a disclosure standard, Financial Reporting Standard (FRS) 13, which currently applies only to companies with listed securities. There is virtually nothing on the accounting treatments that should be adopted.

IAS has had a disclosure standard, IAS 32, for many years. The difference is that it also has a measurement and recognition standard, IAS 39, which deals with the numbers that should appear in financial statements. The basic approach is that financial instruments should be recognised as soon as a contract is entered into. Many financial instruments also have to be stated at their fair values.

This is very different from current UK practice. For example, most companies that enter into a forward currency contract will ignore it for accounting purposes until the money actually changes hands, although under Statement of Standard Accounting Practice (SSAP) 20 they may use the contracted rate in translating related transactions and balances. Under IAS 39, this approach is not acceptable. The contract needs to be recorded immediately. In many cases, this may then need to be retranslated at any balance sheet date, giving rise to a profit or loss.

Severe implications for small companies

For smaller companies, if they are affected by the move to IAS, then the implications may be even more severe. There is no current international equivalent of the Financial Reporting Standard for Smaller Entities (FRSSE), and international standards are noticeably lacking in some of the exemptions available in the UK. For example, IAS 7 which deals with cash flow statements does not include an exemption from preparing such a statement on the grounds of size. If current IAS were adopted in the UK this would mean that many companies would be required to prepare a cash flow statement for the first time. More generally, smaller companies may find that the accounting practices they have to adopt are much more complicated, and that they are required to provide additional disclosure.

As an aside, IAS 39 mentioned above has recently been issued as part of a separate volume, including questions and answers on implementation. This document runs to 572 pages!

There are also some issues with formats. IAS 1 does not prescribe a format for financial statements, although it does contain the basic disclosures that those statements must be included. There is therefore no current equivalent of Schedule 4 and Schedule 8 to the Companies Act 1985, which are themselves based on EU directives.

It seems unlikely that the EU will allow the freedom currently provided by IAS, and there is little doubt that a revised Fourth Directive will be implemented providing details of the formats that companies will have to use. This raises the even more complex question of the interaction between IAS and EU law. To what extent will EU law restrict the free application of IAS? This is a question that needs to be resolved in a fairly short timescale if the 2005 deadline is to be met.

We are currently only at the start of the process of IAS adoption. There are many questions unanswered. The one question to which the answer is obvious is whether this will be a major change. The answer has to be 'yes'.

MARKETING **UPDATE**

Fluctuating fortunes of CRM

Customer relationship management (CRM), quite recently hailed as an essential management tool, is now viewed by some as a major disappointment. **Alan Mitchell** explores the reality.

Alan Mitchell writes extensively on marketing and finance, and is a former editor of Marketing *magazine.*

Readers interested to learn more about CRM can attend the lecture on 28 November in London (see 'Forthcoming events', opposite)

The trajectory of 'customer relationship management' (CRM) from bandwagon to corporate blaming-fest is accelerating fast, as ever more companies admit their CRM investments (worth over $10 billion in software alone) are failing to deliver results. What went wrong?

The basic idea behind CRM remains extremely powerful. Using rich information gleaned from and about customers, companies can focus the right messages and activities on the right people at the right time, thereby eliminating waste in marketing spends and increasing response rates while delivering better value to these customers. This, in turn, can lead to higher customer retention rates and increased cross-selling. A genuine win-win, in other words.

Turning theory into reality, however, has proved extremely difficult. Too many companies have begun ambitious CRM programmes without clear, measurable goals or standards by which to benchmark progress. Companies have struggled to integrate fragmented product or division-based databases to create a single, rounded view of each customer. Meanwhile the ongoing fragmentation of customer 'touchpoints' (eg call centre, web site, billing, retail outlet, mobile phone etc) has made achieving a consistent 'channel-agnostic' customer experience an operational nightmare.

Customisation

To really have lift off, CRM requires at least some degree of customisation of communications and services. But it isn't easy to achieve this in a way that doesn't add mountains of extra cost – and which is actually recognised by the customer as a palpable step forward in value. Meanwhile, lighting upon a useable definition of life time customer value – which should drive CRM priorities – is much harder than seems at first blush.

Other 'softer' cultural obstacles to CRM are proving equally difficult. To work effectively, somebody has to have responsibility – and the authority – to 'manage' the relationship. This customer manager must have the power, say, to stop yet another mailing from product division X if he feels it is undermining the overall 'relationship'. Such differing priorities can create all manner of internal conflicts. Meanwhile, finance directors pressing for evidence that heavy CRM investments will earn a return, have played their part by focusing marketers' efforts on the quick wins: reduced waste in marketing expenditure and increased cross-selling.

This is fine, except that such initiatives rarely result in a genuine customer 'Wow!'. Data-driven customer contact mechanisms do not a relationship make.

Seller-centric

Finally, at the philosophical end of things, it's a hard fact that most customers don't want a 'relationship' with their suppliers, and resent intrusive attempts by suppliers to cosy up. Even if they do have some sort of relationship, they certainly don't want it to be 'managed' by anybody but themselves. More fundamentally, despite its customer-focus rhetoric, most CRM is intrinsically seller-centric. It's driven by sellers' attempts to build relationships focused not on their customers' most pressing needs, but on their particular products and services. Marketing-wise, in other words, it is flawed from the start.

Like so many things in marketing, CRM has been oversold by people with a vested interest. All too often, what they're really promoting boils down to little more than efficient data-driven customer contact strategies, wrapped in the fancy packaging of high-flown marketing-speak. If reduced marketing cost is what you really want, it's probably better to stick with the valuable database basics and to forgo unhelpful pretensions about relationship building.

On the other hand, investing heavily in next-level customer service and customisation can be a high-reward (if high-risk) strategy. However, this route is best followed by only a small number of suppliers who play particularly important parts in their customers' lives; where the customer sees a real point in investing in the relationship.

Unfortunately, there's a killing field of high cost and low return between these two extremes. And this killing field is turning out to be much bigger than most of us ever expected.

FORTHCOMING FACULTY EVENTS – 2001

To attend any Faculty event, please fill out the form which adjoins this page, remove it by tearing along the perforation, and mail it or fax it to Kirsten Fairhurst at the Faculty's address given on the bottom of the form.
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Kirsten Fairhurst on 020 7920 8486.

- 22 November BREAKFAST SEMINAR (Aston Villa Football Club, Birmingham)

'BUDGETING AND PLANNING FOR THE 21ST CENTURY' – JOHN MCKENZIE, ARMSTRONG LAING.

This seminar looks at the increasing inability of budgets to deliver, and explores ways for companies to develop more dynamic budgeting processes that go beyond numbers and tie in with the way businesses consume resources whilst still providing appropriate controls in today's changing business environment. Registration/breakfast 8.00am; seminar 8.30am-10.00am.

- 28 November EVENING LECTURE (Chartered Accountants' Hall, London)

'CUSTOMER RELATIONSHIP MANAGEMENT' – DR ROBERT SHAW, MARKETING BEST PRACTICE INTERNATIONAL LTD.

Customer relationship management (CRM) has established itself as one of the biggest investments that companies are making today. At its best, it drives up customer profitability and shareholder value. But at its worst, it is a disastrous waste of time and money. This seminar describes the critical success factors and the role of financial management. Registration 5.45pm; lecture 6.00pm; buffet and networking 7.00pm.

- 4 December BREAKFAST SEMINAR (Lancashire Cricket Club, Manchester)

'BUDGETING AND PLANNING FOR THE 21ST CENTURY' – JOHN MCKENZIE, ARMSTRONG LAING.

This seminar looks at the increasing inability of budgets to deliver, and explores ways for companies to develop more dynamic budgeting processes that go beyond numbers and tie in with the way businesses consume resources whilst still providing appropriate controls in today's changing business environment. Registration/breakfast 8.00am; seminar 8.30am-10.00am.

RECORDINGS OF FACULTY LECTURES

The following lectures and conferences held by the Faculty in 2001 are available, in both **audio** and **video** format.

To obtain a recording, please tick the audio and/or video box on the tear-off response form opposite.

There is a charge of £5.00 for audio recordings and £10.00 for video.

COMPETING IN THE NEW ECONOMY

David Asch of the Open University Business School considers some fundamental aspects of customer choice in the new IT environment.

DYNAMIC STRATEGY

Mark Thomas of PA Consulting illustrates how companies which adopt this approach can obtain superior returns for their shareholders over the long term.

BEYOND BUDGETING (HALF DAY CONFERENCE)

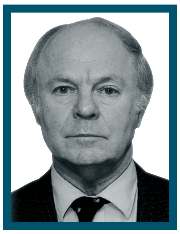
Robin Fraser and **Peter Bunce** of the Beyond Budgeting Round Table CAM-I Inc illustrate how to manage performance better without budgets – plus a contribution from **David Berkeley** of Bulmers.

THE BALANCED SCORECARD

Robin Bellis-Jones of Bellis-Jones, Hill & Prodacapo, shows how the balanced scorecard has enabled the vision of a strategy-focused organisation to become a reality.

Where finance and personnel meet

Continuing his series of articles on effective management **Richard Alston** examines human resources from the financial director's perspective – are they a cost or an asset?



Where does teamwork start and stop? We know that the board is totally and collectively accountable for the efficient and effective management of the company, and that a good board shows itself through responsible collective behaviour by the directors in all matters and at all times. Being 'all one' in the eyes of the law and of the people tends to awaken feelings of 'all for one and one for all'. Board membership is, however, more than a matter of simple teamwork, since it gives due space and weight to professional inputs from directors and, at the same time, creates opportunity for the use of individual excellence.

In the case of the financial director, he or she must put in place an effective internal control system as an essential part of the effective management of the company, and colleagues are required to report collectively on the effectiveness of that control. These processes lead directly into cross-functional activities to establish criteria for assessing the effectiveness of the 'whole system' financial controls, effective and efficient operations, and the safeguarding of assets, and make the financial director a financial adviser rather than a 'policeman'.

Human resources – cost or asset?

In this new framework, the familiar 'cost or asset' debate about people is being revived. As we have seen yet again, given violent fluctuations in manpower demands the personnel department, like any service department, follows the peaks and troughs on a lagged curve of 'buy' or 'sell'. Eg: the dot.com expansion signalled 'buy' (usually at inflated salaries); now collapsing markets indicate 'sell', for savings (less redundancy costs).

However, just as value analysis can materially affect the product or service offered, so 'husbanding people' can show material benefits, both functional and corporate. Four specific actions will have direct financial benefits:

- identifying and keeping the right people for the future, not the past;
- fully evaluating all proposals for performance improvement – especially those from 'direct' work areas (call centre as well as factory);
- distinguishing clearly between job enrichment (profitable) and job enlargement (costly); and
- assessing and measuring operations and work areas usually considered unmeasurable or 'too difficult'.

Co-operation with the personnel director

Effective co-operation between the financial and personnel directors, and then between them and the other directors, all in the context of governance and the corporate plan, can be very potent. Co-operation is an inexpensive financial tool when guided with understanding. The combined use of suitable tools can be significantly beneficial. (If you think knowledge is expensive, try ignorance!).

The fashionable long-term argument that any training is a good thing in itself must, short-term, be qualified by the over-riding appreciation that any action has a cost/benefit or a cost/deficit, that development costs are susceptible to analysis, and above all, that developing the human asset should have both a quantitative and a qualitative benefit, in line with all asset management activities.

Lastly, where labour costs may be anything from 40% (manufacturing industries) to 70% (service industries) of overall cost, look at the relative functional costs of the personnel function – probably ranging from 1% to 3% – and maximise the return.

Good teamwork uses change to build.

Dr Richard Alston ran an international strategy consultancy before his recent retirement. He is now holding distance learning MBA (Management) courses for a private university. Email: rabath@supanet.com.

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