The Institute of Chartered Accountants in England & Wales

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The end of shareholder value

Allan Kennedy believes a new era is dawning

page 3

FINANCE FUNCTION

The case for shared service centres

page 8

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Reduced subscriptions

We have had a number of enquiries about reduced subscription rates to the Faculty – which are given to all members who pay the reduced main ICAEW subscription. Reduced subscriptions are available to members who are unemployed, on a career break to bring up a family, to certain full-time students and to other members on low incomes. To apply for a reduced subscription for 2001, please contact members' registration on 01908 248250 for an application form.

MQ Online is now available

MQ Online is a series of short web-based lectures supplementing the *Management Quarterly* articles. The first five lectures, covering MQ finance articles 3, 4, 5, 6 and 7 are now available for you to trial on the web site. A PDF of the related article is also available for download. We have started with finance, but we are already planning for the marketing lectures.
Do visit the site (the address is www.icaewmembers.co.uk) and let us know what you think, by e-mail to: cdjackson@icaew.co.uk

Big demand for Solihull conference

The Faculty's half-day conference in Solihull is sold out – echoing the success of the September conference in London. The conference is being held on 29 November, and includes a range of speakers, similar to the earlier conferences in this series. Details are on page 11.

Use our 'Events' form

Faculty events for the next two months are listed on page 11. Please use the tear-off slip on the adjoining page to book your place for those lectures and other events you would like to attend.

October 2000 Issue 68

Please note that all changes of address and other new details of Faculty members should be notified to the Institute's members' registration department (tel: 01908 248250 or email: finmreg@icaew.co.uk) – they can also be updated via the web site (www.icaewmembers.co.uk).

Directory of Expertise

Do you ever get stuck on a problem and know that someone somewhere must have already solved it? Or do you just need to talk to someone for ideas on how to do something better? Well, help is at hand...

The Faculty's Directory of Expertise lists members who are happy for you to contact them for advice on a wide range of subjects. Initial contact is on an informal, free of charge, basis.

The directory was originally published as a booklet. We have now transferred it to the web site, giving more flexibility for searching through the database – there are already over 700 members listed there.

There are 43 areas of expertise (see right), subdivided into sector, geographical area and company size. This means that if you have a problem regarding 'joint ventures' in the 'Far East', you may find a member who specialises in both these areas, and ask them for assistance.

Any member who would like further details, or would like to be included in the directory should call Maria Carlstrom on 020 7920 8486. If you do not have access to the internet, call Maria and she will do a search for you and provide contact details.

Faculty web site: www.icaewmembers.co.uk

- Balanced scorecard
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- Costing
- Credit management
- E-commerce/internet
- Environmental issues
- Financial modelling and forecasting
- Grants
- Incentive schemes
- Innovation
- International enterprise
- International finance
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- Investor relations
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- Outsourcing
- Project management
- Purchasing and supply chain management
- Quality
- Risk managent
- Selling a business
- Shared service centre
- Shareholder value
- Small and medium sized enterprises
- Strategic alliances and joint ventures
- Strategic management accounting
- Strategy and organisation
- Valuations
- Value based management
- Venture capital

The problem with shareholder value management

Over the past two decades, many companies have embraced a new driving purpose for their activities – the concept of management for 'shareholder value'. This has altered the way in which managers are rewarded, shifting the emphasis to stock options and hence aligning the interests of such managers with those of shareholders.

But leading business writer **Allan Kennedy** questions the general assumption that the shareholder value principle rules supreme. He points to a powerful backlash against companies espousing the shareholder value principle alone. Leading this protest are stakeholder groups such as employees, customers, government, and suppliers, all of whom feel themselves disadvantaged by the 'excesses' of the shareholder value era, which he identifies as downsizing, rationalisation, constant mergers and acquisitions, and general 'short-termism'.

In his new book 'The End of Shareholder Value', Kennedy looks at the real – and, in his view, disturbing – effects of this phenomenon. He describes the changes which have taken place in relationships between companies and these stakeholder groups, and how companies now face a new challenge – that of redressing the balance, to concentrate on wealth creation for all parties. He examines a range of companies – from long-established businesses such as Dow Chemical and General Electric of the US to new 'dotcoms' like Amazon.

In this edited extract, he states his general case against managing for shareholder value alone. Whether you agree with him or not, his analysis is challenging – to obtain his book, see page 5.

HELEN FEARNLEY

My intention in writing 'The End of Shareholder Value' was to alert managers everywhere – but especially in the US, where shareholder value thinking reigns supreme – to the dangers inherent in a single-minded focus on this objective.

In the UK and Europe, however, the shareholder value movement, though gaining strength, has not yet swept aside all other notions about corporate purpose. My hope for European readers, then, is that discussion of these subjects will both help them avoid the excesses so apparent on the US business scene yet allow them to recognise the strong points of shareholder value thinking.

What is shareholder value and where did it come from?

Shareholder value had its origins in the observations of a number of academic accountants who saw that they could better predict stock market price levels by discounting future cash-flow streams associated with a business rather than analysing accounting measures of performance such as earnings per share.

The idea might have stayed in the academic world had it not been spotted by a new and very aggressive breed of American investment banker in the late 1970s and early 1980s. These bankers used the insight of the academics to launch raids on companies whose shares appeared to be undervalued in the stock market.

When their raids succeeded, they proceeded to restructure the firms that came under their control to release their hidden reserves of value, then sold the reinvigorated companies to new owners – having made exceedingly handsome profits in the meantime.

The very real threat from these raiders caused business people across the board to begin to pay attention to the idea of shareholder value. Starting in the US, where the raiders were first active, companies in the 1980s began to realign executive compensation schemes to place an increasing emphasis on stock options, tying senior managers' future pay directly to their success in raising companies' stock prices.

Driven by these incentives, managers began to mimic the raiders by restructuring their operations to get rid of underperforming parts; cutting costs to improve across-the-board performance; closing older plants; moving production to new, lower-cost venues usually in other areas of the world; and outsourcing any activities that outside vendors could accomplish at a lower cost.

The results of these activities, especially in the late 1990s, were significant increases in corporate performance and profitability, an unprecedented rise in stock market values, and booming executive pay levels as managers cashed in on what had become extremely valuable options at the peak of the bull market in equities.

What went wrong?

Along the way to these higher levels of performance and executive pay, a subtle change in thinking emerged. Initially, the shareholder value approach and the analytic tools that accompanied it had been a useful resource for managers looking to do their jobs better and improve the performance of the companies under their care.

As more and more managers were paid with stock-options and as the US equity markets soared in the 1990s, this means to a sensible end became an end in itself. Top executives in many companies saw that they could achieve remarkable personal wealth by making sure they pushed their companies' stock prices to new heights.

By the end of the 1990s, shareholder value thinking had turned into a farce. It had become short-termism coupled with an extant view that getting as much as you can as quickly as you can is an acceptable modus operandi in the world of commerce. If you have any doubt that this is what happened, just look at the rationale behind many of the dot.com startups rushed into the stock market in the closing years of the 20th century.

Suddenly managers everywhere were making decisions solely on the basis of whether the outcome would spur their stock prices ever higher. If more cost-cuts were called for, so be it, whatever the long-term consequences. If internal costs were slow to come out, turn to your suppliers and demand dramatic reductions in their costs as a price of continuing to do business with you.

If cutbacks in research and development (R&D) were necessary to make the numbers, then cut back R&D. If that failed to produce the desired outcome in the stock market, take the money that might have been invested in building the business and buy back stock on the market. And if all that still did not drive up the stock price,

What can be learned from the shareholder value era?

The shareholder value movement would never have gained such primacy in the minds of corporate managers, board members, and investors if it had not brought with it something valuable. What it brought was a heightened sense of managerial accountability for performance. Before this movement came centre stage in the mid-1980s, many companies were run by their managers as near personal fiefdoms; they answered to no-one for results.

Some companies moved from crisis to crisis with no concern about their languishing stock market prices. Other companies preferred to rest on their laurels, continuing obsolete strategies and producing mediocre financial results while watching their market shares decline steadily because of inroads from more aggressive companies, often overseas firms. Still other firms tried to do what was right to improve the performance of their companies but shackled themselves with misplaced loyalties to old products and uncompetitive factories and approaches to the marketplace.

In the relatively benign corporate governance environment leading up to the 1980s, the managers responsible for these often lacklustre results were left in place long after their sell-by dates had passed, carrying on the tradition of mediocrity they had inherited from their forebears.

The rising tide of shareholder value thinking put an end to all this. Companies that persisted in underperforming suddenly became targets for unwanted take-overs. As more and more managers and board members recognised the threat, managers in companies that failed to improve the bottom line were removed by their suddenly interested boards. Moreover, as executive compensation became more heavily influenced by stock options, and senior managers realised they had a lot to gain by taking steps to boost performance and encourage the stock market to look more favourably on their shares, scores of managers began to run their enterprises more effectively on their own initiative.

Shareholder value thinking, therefore – along with technology and a relatively favourable economic and fiscal environment – can take a substantial share of the credit for the undoubted gains in productivity and performance seen in the 1990s.

cook up another blockbuster deal to get Wall Street's attention.

Interests of other stakeholders trampled

In the race to maximise shareholder value, the interests of other legitimate stakeholders were trampled. Loyal long-time employees were laid off or forced into early retirement. The ranks and economics of suppliers were decimated by repeated demands for lower prices and increased services. Government incentive plans were exploited to the fullest to fund the next shift of a plant from one part of the world to another, lower-cost locale. Even the interests of customers were neglected as companies pruned long-standing product lines to leave only the most profitable items and used aggressive price tactics to extract every last coin from the consumer's pocket.

Stakeholders' reaction threatens future corporate welfare

Of course these mistreated stakeholders reacted, and the vehemence of their reaction is threatening future corporate welfare.

In the US, a tight labour market brought on by the unprecedented economic expansion helped workers in their rapid move towards a market-based employment system in which people look out for themselves and their own careers and use every means available to charge employers top money for their talents.

Suppliers who survived the onslaughts of the late 1980s and early 1990s consolidated so quickly that in many industries they now hold the upper hand over the companies they sell to. Customers showed their disdain for how they were being treated by taking back the loyalty they had once invested in brands and buying from the cheapest outlets, increasingly over the internet. Even governments, historically slow to act, have begun to level the playing field for themselves so that corporate opportunism will eventually find few outlets.

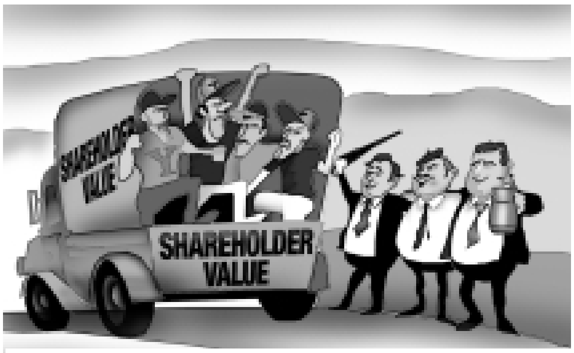
Opportunity for UK and other European managers and investors

The shareholder value movement that swept the US in the late 1980s and the 1990s has been much slower to gain full acceptance in Europe for a number of reasons – some substantial, others circumstantial. For example, workers' rights are enshrined in law in Germany, making it much harder for German companies to pursue maximisation of the welfare of one class of stakeholder, the shareholder, at the expense of others. Similarly, across much of Continental Europe, long term equity holdings of banks and insurance companies insulate managers from the short-term pressures felt by their counterparts in the US.

Even in the UK, whose system of commerce is most similar to that of the US, differences in both philosophy and practice have held back the forces of change that shareholder value thinking unleashed in America. For example, the reliance on a non-executive chairman to head UK companies, in sharp contrast to the situation in the US, has built a degree of distance into corporate governance and virtually guaranteed that the stock-option-induced incentives at work in the US are generally not present.

Whatever the specific reasons, Europe is blessed by not yet having jumped on the shareholder value bandwagon. Despite the presence of these institutional barriers to the adoption of shareholder value thinking in Europe, the movement has nonetheless had an impact on how business is conducted. In the mid-1980s Lloyds Bank (now Lloyds TSB) became one of the first major European companies to begin looking at its business portfolio from a shareholder value perspective. Many would credit its emergence as one of Europe's leading financial institutions to the ongoing results of this scrutiny. The newly merged Asea Brown Boveri was driven to excel by its intense focus on creating shareholder value, among other things. Many other companies in the UK and on the Continent followed the lead of these trend-setters to achieve sizeable performance gains.

However, neither the UK nor the rest of Europe rushed to make it the be-all and end-all of business it became in



'Europe is blessed by not having jumped on the shareholder value bandwagon... '

the US. The debate about its importance continues to this day. Some pundits on the European business scene continue to push the argument that for European companies to regain their competitive edge against US enterprises on a global basis, they will have to move to a more shareholder-centric view of the world. That there is concern about competitiveness and a lack of consensus on whether the shareholder value route is the way to go is tremendously good news for Europe as a whole and EU companies in particular.

The adoption of shareholder value thinking to the exclusion of everything else has likely affected the prospects of US companies. Despite the stock market's record level, this future does not look bright. Many US companies should long ago have begun rethinking what they are all about; they will probably do so when the stock market bubble finally breaks.

In the UK and Europe there is still time for companies and managers to extract the best from shareholder value – especially the notion that performance really counts and managers ought to be held accountable for it – while avoiding the downside so many of their US counterparts now face.

Allan Kennedy is a writer and management consultant to a wide variety of organisations in the US and Europe.

Faculty members can obtain copies of 'The End of Shareholder Value', retail price £18.99p, at the discounted price of £15.99p inclusive of post and packaging, from: Littlehampton Book Services, Direct Mail Order, Faraday Close, Durington, Worthing, Sussex, BN13 3RB. Tel: 01903 828503, quoting reference: Shareholder 1.

The inner business of creativity and innovation

In their address to the Faculty conferences, **Marian Moriarty** and **Dave Smith**, founding partners of the Inner Business consultancy, have been giving a fascinating insight into how innovation and creativity can be fostered in an organisation.

With both UK and international clients, Inner Business's Dave Smith and Marian Moriarty produce results through acting as consultants in innovation projects and also training employees in related techniques. For the purposes of the Faculty conference they dealt with the subject in three distinct segments: the perspectives around creativity and innovation; the tools and techniques generating innovative behaviour when required; and how to apply them.

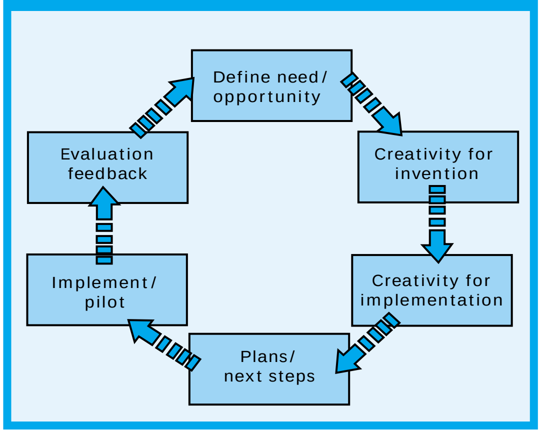
Perspectives around innovation

Setting out to answer the burning question of why one should wish to innovate anyway, Smith and Moriarty suggested two basic motivating factors. The first arises when a business needs to do something different as a reaction to a new development – such a development being anything from increased competition in its market, to internal problems, dissatisfaction with its existing options, or a surprising development. The second motivation is simply the organisation's wish to innovate routinely, as a management tool for success.

And as the strength of either or both motivations may fluctuate over time, according to changes in circumstances, the degree of innovation encouraged within the business can be adjusted to match the prevailing (and counterbalancing) requirements for stability and change.

Innovation, they clarified further, is a process, of which creativity is merely a part. The process itself can be depicted, as shown in Figure 1. The management defines a need or opportunity; creativity is used to generate both innovative ideas and means for their implementation; plans are made for the necessary next step; that next step is implemented, by way of a pilot project; and feedback and evaluation are then generated about the innovative idea.

FIGURE 1 HOW INNOVATION WORKS



Creativity, Smith added, is "about inventing new things, solving problems, inventing a different process, doing something better, finding an alternative...having ideas".

Good examples of the genre, he went on, include:

- George de Mestral's formulation of Velcro, after country walks demonstrated to him the fastening properties of burrs; and
- Art Fay's invention of the Post-it note for 3M, after realising that a glue that had been developed to be super-powerful – but failed miserably – could be used for those little yellow message pads.

To illustrate the contributory factors in the successful innovative process, Smith and Moriarty produced the somewhat tricky diagrammatic evocation of Figure 2. This model shows that from a stated purpose (to be innovative), and given the support of the columns representing identity (embodying a person's skills and abilities), plus beliefs and values (instrumental in his/her behaviour), the right environment can be supported for engendering creativity and innovation.

However, the model's relative simplicity is an optical illusion. As a moment's further study shows, elements of the model defy a single perceptual interpretation. In the figure some of the vertical elements (identity, beliefs, values) merge into one another, according to shifts in one's perception.

Thus, just as in reality, their inter-relationship is by no means clear cut. Nonetheless, all three are important ingredients for the following reasons:

- *beliefs* – individuals' perceptions of the way the world works enable them to filter out what would be useful to know and do from what would not, what might work and what may not;
- *values* – their ideas on what is important, right, and wrong will shape their ideas; and
- *identity* – their sense of self, in particular whether or not they feel themselves to be essentially creative, will affect their ability to generate innovative ideas.

Most importantly, all of the above grow out of a sense of purpose, as the model shows. This can be either at a fundamental level (ie 'I/we are alive today because...') or a situational one (eg 'my purpose in coming to work is...'), but it is the vital underpinning

FIGURE 2 THE PROCESS

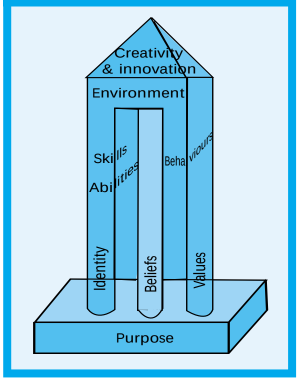
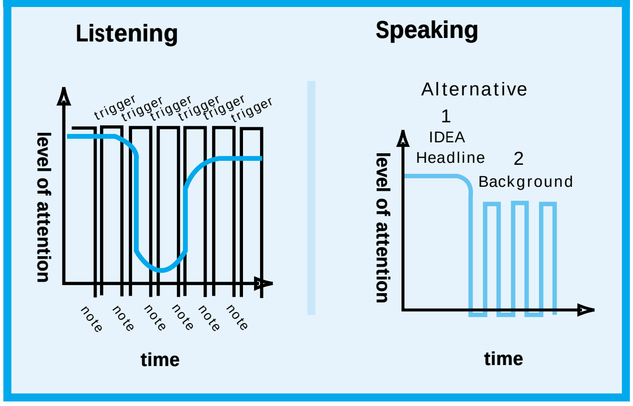


FIGURE 3 THE ATTENTION FACTOR



of the structure.

Inner Business, therefore, aims to help those running businesses to provide that solid foundation of purposefulness, as well as addressing the other elements intrinsic in fostering an innovative environment.

Further, Moriarty pointed out that there are two equally important elements in creativity – the ability to generate many alternatives, and the capacity to turn some of those alternatives into practical action – and, in her own experience, it was the inability to combine both successfully that contributed to the downfall of most ideas.

Going on to explore exactly what is intended when attempting to be creative, they said that it is an effort to make the connection, through a new idea, between the old – a given task, its problems and opportunities – and a fresh way of going about things.

Cultivate random connections

It is important always to be open to such connections. One way to do so arises out of an inherent 'flaw' in our attention. Experiments have shown that attention levels – even with the best of intentions – are strictly limited over time. As Figure 3 'Listening' demonstrates, attention to a speaker stays at a high level only for a matter of seconds before dipping as thoughts wander. And although the listener returns his or her attention to the speaker after a similarly short period, it is at a slightly lower-level high than in the first instance.

Thus during a conversation, or a business meeting, the listener is undergoing a frequent oscillation between inattention and (slightly diminishing) attention. And in the wandering snatches, is probably experiencing the sort of free-associating connections which are vital to the creative process, if they were only harnessed.

So, noting down the random thoughts occurring in such periods of drift can be a useful tool in creativity.

State your idea briefly

Additionally, once one has conceived a new idea, knowledge of this limited listening pattern can also be useful in pitching that idea to others. Referring again to Figure 3 'Listening', it is easy to see that the usual tendency to tell the whole detailed background to an idea, then recap, is not ideal.

Spending more than a short amount of time initially to explain the idea means that the listener has drifted off in the middle of that exposition.

Far better, then, to state the idea very briefly at the start, in a fully formed sentence (proven to be much easier to recall than a mere phrase or note), then go into the background detail (see Figure 3, 'Speaking').

To generate ideas, Smith and Moriarty suggested a variety of ways of stimulating the imagination, including doodling, role-playing, looking at similar problems in other worlds/industries, delving into metaphor and analogy, and getting out into a natural environment.

They also cautioned that one of the main deterrents to generating good ideas was the tendency to be too goal oriented. At this stage, ideas can be incomplete, badly directed, absurd, wishful, speculative. There should be no self-censure, and no feeling that one is not expert enough to venture an opinion.

Selection

When it comes to selecting appropriate ideas, however, more rigorous standards must apply. Moriarty said that the tendency to think of one idea as the solution, is to kill it dead. Instead, she recommended that the selection of ideas should be non-exclusive, and based on a combination of practicality and "a strong sense of intrigue".

The development process

The process by which the chosen ideas are developed is iterative rather than linear. It first involves identifying which ideas – or elements of them – work (aiming for as long a list as possible), and also identifying those that don't. Then a further ideas generating exercise is undertaken, to find solutions to the non-workable parts.

In this way, Moriarty noted, exciting but impractical ideas can be turned into practical ones (though sadly, she added, it is unheard of for the development process to turn a dull but practical idea into an exciting one).

Applications

Having looked at perspectives around innovation, and the tools for achieving it, Smith and Moriarty turned to the application of these tools.

The whole innovative process, they recapped, involves that cutting loose stage of generating ideas and making connections (however tenuous); then the selection process (incorporating both ideas that are 'do-able', plus those that are more intriguing but practically challenging); and finally developing this selection through an iterative process of building and modifying. The ultimate hurdle, they said, is getting to action, ie coming up with recommendations on how to incorporate the idea, who will be responsible for what, and on what timescale.

Dave Smith and Marian Moriarty can be contacted on tel/fax: 01409 271 191; email: dsmith@innerbusiness.co.uk, or mmoriarty@innerbusiness.co.uk

Adding value through a shared service centre

Peter Atkinson, managing partner of the Atkinsons consultancy, describes how and why the Mirror Group transformed its finance function into a shared service centre, and the benefits that ensued.

Establishing a shared service centre can transform a finance function by freeing management from the routine production of information, allowing them to add real value through analysis and interpretation of financial data. This is demonstrated in the case of the Mirror Group, outlined below.

Mirror Group shared service centre – the background

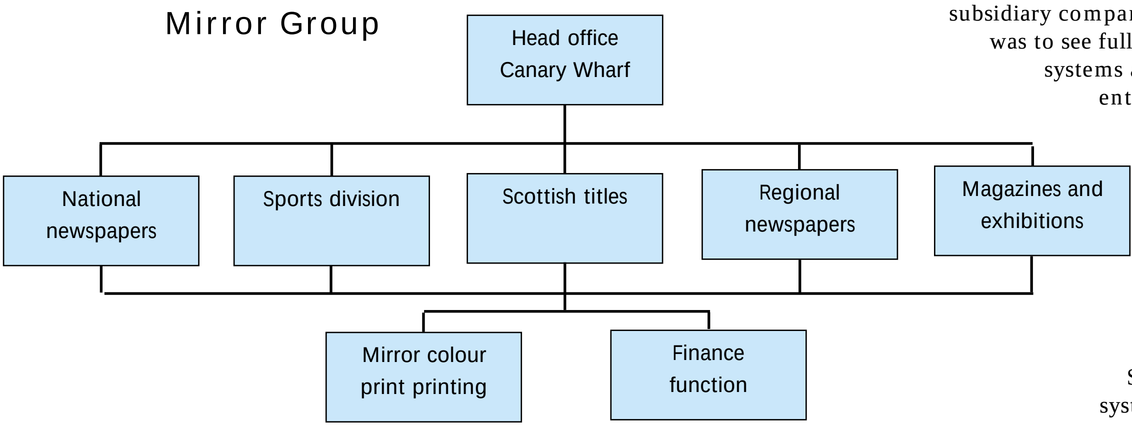
In the late 1990s, Mirror Group acquired Midland Independent Newspapers (MIN) for £305 million. The new group had 6,100 employees and a combined turnover of £697 million, making it one of the largest newspaper companies in Europe.

John Allwood, Mirror Group's finance director at the time, felt that the time was right for taking a radical look at how the finance functions of both MIN and of Mirror itself were working. As a result Atkinsons were employed as consultants to look into the future operating structures required.

So how did Mirror Group set about this radical review?

The group needed to realise benefits from the purchase of MIN quickly but wished to start with a dispassionate review of the finance function within both businesses and be presented with some radical options for the future. The scale of the enterprise presented some unique challenges. The group handled around 86,000 sales invoices per month, had a total of 89,000 suppliers on its books and dealt with 3,300 expense claims per month. After considering undertaking the project in-house it eventually engaged my firm, Atkinsons, to work alongside its own staff to assist in the task.

Corporate structure of Mirror Group



Allwood has since said that our direct experience of introducing significant change to finance functions (he had noted my own earlier role in introducing a radical change programme to the finance function within United Provincial Newspapers [UPN]) was relevant to the Mirror Group's requirements.

The initial review was completed in a matter of weeks and recommended possible future scenarios, enabling senior executives to develop their vision for the future of the function, taking account of the likely implications of implementing that vision. The review summarised the group's (then) current practice by individual process and developed a strategy for the future which harnessed recent IT developments.

Changes were suggested, designed to introduce best practice to the group and these were summarised in a detailed planning document, which took account of realistic implementation timescales, the dependence on IT installations and the need for good communication and staff training.

What did they decide?

The vision for the future was to see the creation of a shared service centre (SSC) handling many of the financial transaction processing needs of the enlarged group, with a remaining local presence for credit control and management accounting. The new arrangement would cut across the divisional structure of the operating business units as finance was to be seen as a service provider for the entire business (see 'corporate structure', at left).

MIN was structured in a very traditional and autonomous way with finance centres operating within each main subsidiary company. The future vision was to see fully integrated finance systems applying to the entire organisation. These systems would handle payroll, accounts payable with general ledger, and accounts receivable.

Standard accounting systems and procedures were to be used avoiding as much duplication of work as possible. In addition individual processes were reviewed with a view to reducing the volume of transactions being handled by the finance function.

In the end it was decided to operate with two shared service centres in order to capitalise upon the staff skills available within the group. One centre in Birmingham had 20 staff dealing with accounts receivable, whilst the other in Canary Wharf dealt with the remaining finance processes with just 14 staff.

The accounts receivable centre had modern communication links to local credit control functions (which have remained at local level) and also handled query processing.

How were the necessary changes introduced?

Mirror managed to hit the ground running by using experienced consultants and by having a very clear vision of where the finance function was going. Planning took place at process level without losing sight of the overall target milestones. The plan dovetailed with changes that were taking place in the rest of the business, particularly with the IT and production systems.

A shared service centre is a method of organising and operating a company's support processes from a centre of excellence to one or more business units. The concept originated in North America where it has traditionally been used by multinationals.

Technology and communications have reduced the levels of human input required. SSCs are now regarded as one of the most effective models for large finance functions, typically leading to savings of 25% to 40%.

The outcome

Workflow techniques have been expanded for the centralised purchasing function. There is a central integrated accounts receivable ledger, one payroll and expense system, and one core general ledger, integrated to the other systems.

In total the project produced savings in excess of £500,000 and a 20% reduction in the finance department headcount. Allowing for all costs, the payback for the whole project was less than two years, with the savings continuing to accrue.

The future

Having completed this project, Mirror Group have merged with Trinity plc to form one of the largest newspaper publishing groups in Europe. Prior to the merger, Trinity were also introducing the shared service centre concept.

Peter Atkinson launched the Atkinsons consultancy three years ago to provide services designed to help organisations become more efficient.
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ABSTRACTS FROM LIBCAT

Smith M – Innovation diffusion
Management Accounting (CIMA), Vol.78. No.6. June 2000: p40-41(2 pages)
● *The take-up of management accounting innovations is dismally poor. Surveys in the US, the UK and Australia cite adoption rates of no more than 14%, even for "mature" innovations such as ABC. They also show abandonment rates as high as 90% among those that do choose to adopt. So, while academics may love new ideas, businesses are not biting. The author looks at the reasons why.*

Triplett A – Managing shared services with ABM
Strategic Finance, Vol.81. No.8. February 2000: p40-45 (5 pages)
● *Shared service centres are a boon to large companies, often resulting in lower costs and better customer service, and firms are discovering that activity-based management (ABM) techniques are made to order in helping them manage and report such operations. Research by Gunn Partners in its 1999 Global Shared Services Research project revealed that by the end of 2002 nearly 70% of the researched companies will have implemented ABM.*

Cecil B – Service stations
Financial Executive, Vol.16. No.1. January/February 2000: p32-35 (4 pages)
● *Most of the largest US domestic companies have established shared service centres for handling transactions. The concept is catching on in Europe, too. But will shared services work in other parts of the world? The scope of functions in shared service centres now goes beyond transaction processing activities in finance. In fact, such centres are breaking through traditional functional silos to become business service hubs throughout the world.*

Mills R.W – Beyond shareholder value – reconciling the shareholder and stakeholder perspectives
Journal of General Management, Vol.25. No.3. Spring 2000: p79-93 (15 pages)
● *Shareholder value is rapidly becoming the dominant management ideology. Does this mean that shareholders have won, at the expense of other stakeholder interests? The authors report.*

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How the agencies assess risk

Chris Mansell explores the risk analysis practices of the rating agencies; and highlights the statistical imperfections of the inflation figures.

The conventions used by the rating agencies, such as Moody's and Standard & Poor's, for analysing the broader risks attaching to a particular debt issue can be helpful to an organisation contemplating a major investment or acquisition. At the 'macro' level there are two main categories:

Sovereign risk – which evaluates potential problems in the country in which the investment is made, for example:

- whether or not an investment can be financed through local currency borrowings or offshore in a proxy currency is important. If transfers out of the country are essential to achieving payback, what are the risks of such flows being barred by local regulators or the currency market becoming illiquid?;
- two factors are of prime concern: the track-record and policies of the state in its economic management, along with the private sector response to such events. Future prospects also come into play, for the current account balance, inflows of funds and ultimately, the stability of the currency; and
- the agencies rarely rate debt above the level of the sovereign risk. This looks to be a valuable basic principle for all forms of investment.

Industry risks – which evaluate the particular downsides and opportunities which can be identified with the industry in that country, for example:

- trends in world-wide competition have to be taken into account as does the importance of a particular industry to the host nations' economy. The structure of an industry within the country sets the scene along with its maturity, unused plant capacity and expected growth relative to the rest of the economy;
- the level of government intervention, historic and potential, is also a factor. Indeed the entire regulatory environment needs to be considered – the risk of taxation changes which might impact on a particular industry, and of course changes in the labour laws; and
- ease of and barriers to entry are also relevant, along with the industry's vulnerability to technological change.

The agencies look at a company in its broader context. The promoters of an acquisition or investment within the organisation will naturally home in on the detail of the target, often to the exclusion of the wider strategic considerations. Finance managers can learn from the rating agencies' approach.

Inflation obscured

Accountants are conditioned to looking at all financial figures with deep suspicion, for example when a company is reporting under different regulations such as UKGAAP, USGAAP or the German conventions. The difference can be startling. Treasury managers who expect UK interest rate decisions to be driven by trends in inflation should be equally cautious.

The monthly announcement of RPI – the headline figure – upon which many analysts hang their projections, is less conclusive than it might appear. Erratic lumps in the graph as budget measures drop in and then out are familiar enough, but there are other wrinkles. RPIX is a formal measure which addresses this in part by excluding movements in mortgage-interest payments, so the effect of eliminating mortgage tax relief and recent shifts in interest rates have had no effect on this index. The difference between RPIX and RPI – both the amount and whether it is positive or negative will depend mainly on the state of the interest rate cycle. In July the RPI was 1.1% higher at 3.3%, leaving RPIX, the measure used by the government for targetry, at 2.2% just inside the policy objective of 2.5%.

Apply the European criteria for measuring inflation and the picture blurs totally. The Harmonised Index of Consumer Prices (HCIP) is the measure used to compare rates of increase across the European Union and by the European Central Bank to target inflation. The figure for July was 1.0% and the UK apparently enjoys about the lowest rate of inflation in Europe. As they say, 'not many people know that', although the Engineering Employers' Federation is pushing for its adoption.

Even more significant is the difference in statistical techniques. It sounds obscure but in fact is critical as the one used by HCIP assumes that consumers adjust their purchase pattern according to price level – if they see a special offer they buy it. The UK index assumes that consumers follow their well-worn purchasing grooves irrespective of relative price changes.

Credible? Experts have calculated that effect to be worth an extra 0.6/0.7% on the RPIX – month-in and month-out. Again in the context of the 2.5% target that is substantial. Treasury managers need also to bear in mind that inflation figures, along with press comment thereon, have to be treated as sceptically as ever.

FORTHCOMING FACULTY EVENTS

CONFERENCE PROGRAMME 2000

~~**29 November**~~
~~SOLIHULL~~

The Faculty's series of half-day conferences moves to Solihull, and includes a range of speakers. The timetable will be:

9.00	Registration and coffee.
9.25	Welcome and introduction.
9.30	'The development of strategic performance measurement' *Kevin Bounds, director of world class finance – insurance, KPMG Consulting.*
10.30	'The balanced scorecard – what and why?' *John McKenzie, director, Armstrong Laing.*
11.30	Tea/coffee.
11.45	'The inner business of creativity and innovation' *Marian Moriarty and Dave Smith, Inner Business.*
1.00	Buffet lunch.

Kevin Bounds is director of world class finance – insurance at KPMG Consulting, after a line career in financial services, which included being finance director for NatWest Life and then Nationwide Life. Kevin also sits on the executive committee of the Faculty. John McKenzie is director of sales and marketing at Armstrong Laing. He is a member of the Finance Faculty of the Management Centre of Europe, based in Brussels, where he teaches on performance measurement and financial planning and control courses. Dave Smith spent 15 years working in R&D: amongst other qualifications, he has a degree in applied biology. Dave has a deep interest in metaphysics, which led to him create Inner Business with his partner Marian Moriarty. Marian Moriarty, a founder of Inner Business, works as facilitative consultant, trainer and coach in the fields of creativity, innovation and change management. She spent eight years as a marketeer with an American multinational.

From left to right: **Kevin Bounds, John McKenzie, Marian Moriarty and Dave Smith – pictured at the April Huddersfield conference**

31 October
LECTURE
LONDON

Matt Davies of CPD ATC Ltd provides a review of both the theory of value based management (VBM) and the evidence which is emerging about how VBM is being used in practice. Registration 6.00pm – 6.30pm, lecture 6.30pm and buffet 7.30pm.

***Matt Davies** is a director of CPD ATC Ltd, a company that provides tailored finance training for corporate and professional clients. Prior to joining ATC last year, Matt spent six years at Aston Business School where he specialised in VBM-related teaching, writing and research. Through his research, Matt has interviewed senior executives of more than 20 major UK companies that have experience of using VBM in practice. Matt's main publications in this area include 'Shareholder Value' (FT Management, 1997) and 'Value Based Management: context and application' (Wiley, 2000). Matt is currently responsible for the VBM components of the MBA programmes at Warwick University, Queen's University Belfast and Aston Business School.*

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 DEBBIE CAME AT THE FACULTY'S ADDRESS GIVEN ON THE BOTTOM OF THE FORM

Europe's commitment to enterprise

In the third of his regular columns about the European Union, **Martin Manuzi**, from the Institute's office in Brussels, argues that there are merits in the new EU Charter for SMEs

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LETTER FROM BRUSSELS

A few weeks before the traditional summer shut-down of Europe's policy-making machinery, a special European Charter was approved setting out policy priorities for small enterprises. On the surface, this appears an innocuous and possibly irrelevant document full of empty 'sound-bites'. However, its potential for spurring an improvement in the regulatory environment for small businesses across Europe should not be under-estimated.

To the sceptical, the Charter could furnish ample ammunition for a critical onslaught. While it would be difficult to disagree with its fundamental principles – essentially, the need to recognise, applaud and reward successful enterprise – critics might ask whether a non-binding Charter littered with 'could and should' statements is really the best that the EU can offer.

The more specific 'lines of action' focus on critical issues such as the simplification of regulations on business, improving access to finance, the promotion of technological capacity and the use of e-business models. The question of facilitating start-ups also figures prominently – not surprising given that setting up a business in the EU is three times as costly as in the US. Most importantly, perhaps, reference is made to the need to review bankruptcy legislation and tax regimes to ensure that success is rewarded and risk-taking is not penalised. But on all these matters, the Charter does not clearly identify the division of responsibilities between European institutions and member states. The decision to omit deadlines for the achievement of specific aims is also striking.

But it would be unfair just to be critical. In the first place, the Charter ought to be viewed in the framework of the EU's concerted effort to ensure that the impact on enterprise is fully taken into account where the preparation of all new legislation is concerned. 'Think small first,' has become the informal rule in the EU policy-making arena with the objective of avoiding undue burdens on small enterprise. In the past, the Commission really only dabbled into the question of simplifying existing legislation through programmes such as SLIM (Simpler Legislation for the Single Market Initiative) and BEST (Business Environment Simplification Task Force). In Brussels it is now widely accepted that the principles behind these programmes have to be implemented far more broadly.

The Charter's most important feature, however, is that it provides the first European political 'benchmark' against which the policies of the European institutions and those of national governments can be assessed, judged and openly criticised for the effects they have on small enterprises. It is an approach based essentially on 'peer pressure', which the Commission has successfully implemented through the 'single market scoreboard' which 'names and shames' member states which are slow to implement EU legislation.

Benchmarking and the dissemination of best practice among entrepreneurs figure prominently in the Commission's Multi-Annual Programme for Enterprise and Entrepreneurship, due to launched in the next few weeks. It is backed up by a L200 million budget to implement a variety of projects to promote the interests of SMEs and to encourage greater cross-border contact between European enterprises. However, it is clear that the Commission's Enterprise department alone cannot tackle the many hurdles which exist to an improvement in the European business environment. This requires a broader political consensus and commitment – and, despite first impressions, it is clear the Charter goes some way to demonstrating this.

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