ICAEW FINANCE & MANAGEMENT FACULTY

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FINANCE & MANAGEMENT

“FINANCE CAN COME UP WITH INSIGHTS THAT OPEN THE MINDS OF OTHER PEOPLE” PAGE 10

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Putting sustainability at the heart of the business

The meetings monster
Better engagement with staff

Growth strategy
Morgan Witzel on the organic approach to decision-making

Face forward
How SMEs can use data to improve performance

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"A large part of any senior job is being a firefighter. You're there to prevent things going wrong and to do something about it if they do"

Andrew Lewis
Group FD,
Avon Rubber

Tackling tough times together

ICAEW FINANCE & MANAGEMENT FACULTY

We have entered 2012 with the continuing eurozone crisis and a considerable amount of economic uncertainty in the markets. Despite the gloomy outlook, the UK has managed to keep its AAA rating. However, to maintain this top ranking,

there is immense pressure on the government to coordinate economic reforms and spending cuts into a long-term strategy.

To cope with the ongoing uncertainties, we want your faculty to be the first point of reference. We aim to make sure you are provided with the vital resources to help you perform at your best during 2012.

Last October, the annual technical needs survey indicated members had requested similar topics from previous years. Business performance measurement (BPM) clearly ranked top for another year, with business improvement, managing change, financial modelling and forecasting, and financial strategy rounding out the top five topics requested in 2011.

This month, BPM is highlighted in our cover story. Stacey Barr outlines (on page 18) a six-step BPM process applicable to SMEs and shows that business goals can be met by working with a well-selected set of highly relevant performance indicators. Barr explains how, by carefully applying the right lead information, you will be able to pinpoint where your business processes are weakest.

Thank you to those who completed the survey, as your feedback provided a helpful insight into your key concerns. If you have any further comments, please feel free to contact me at jennifer.chong@icaew.com. Alternatively, you may wish to contribute to the running forum of various issues raised on our two LinkedIn groups:

- ICAEW Finance & Management Faculty; and
- ICAEW Women in Finance Network.

And finally, 2012 is shaping up to be a year of change. You will have noticed some fresh changes to your faculty magazine. Your feedback is most welcome, so please contact me with your thoughts.

Jennifer Chong
Technical manager

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News on the financial front

RAYS OF HOPE ON THE ECONOMY

A series of negative economic forecasts dented confidence at the start of 2012. But there are, at least, some silver linings.

While the IMF cut its prediction for global growth to just 3.3% this year, and UK GDP was shown to have contracted 0.2% in Q4 2011, some indicators are heading in the right direction.

"Inflation should fall back below 2% this year, as commodity prices weaken and the VAT rise drops out of the calculation," says Professor Peter Spencer, chief economic advisor to the Ernst & Young ITEM Club.

At the same time, while director sentiment on the UK and global economies is generally weak, many senior managers are markedly more confident for their own companies – perhaps this is as a result of having to develop mechanisms to cope with a flat-lining economy.

In a CBI survey in October, 70% of executives said their confidence in the economy was down – but only 30% had more negative sentiment about their own business.

And in the ongoing FDs' Satisfaction Survey, in association with ICAEW, nearly 50% of FDs and FCs say they are more optimistic about their own business – but only 7% are more optimistic about the UK economy in general.

PENSION REFORMS: REPRIEVE FOR SMALLER EMPLOYERS

Since Liz Cole's article *Employer Duties To Provide Staff Pensions* in November 2011 (F&M 193), the government has introduced a revised timetable to extend implementation of workplace pension reforms for employers with less than 250 staff.

Under the new auto-enrolment timetable:

- all employers with 250 or more staff will remain on the original implementation timetable and should continue with their staging dates unaffected between 1 October 2012 to 1 February 2014;
- medium-sized employers with 50-249 staff will be re-allocated staging dates between 1 April 2014 and 1 April 2015. Small employers with 49 or fewer staff will be allocated various staging dates between 1 June 2015 and 1 April 2017; and
- minimum contributions will increase from 1 to 2% of banded earnings on 1 Oct 2017 (previously 1 October 2016), increasing to 3% from 1 October 2018 (previously 1 Oct 2017).

The Pensions Regulator website – thepensionsregulator.gov.uk/employers – has up-to-date information for employers and advisers, including detailed guidance explaining the new auto-enrolment duties. Look out for further guidance from the regulator, which can be done by signing up to the regulator's free news-by-email service.

The ICAEW will be planning events on these new employer responsibilities during 2012. To register your interest, email aude.bezler@icaew.com.

FDs' EXCELLENCE AWARDS 2012

Since 2005, the FDs' Excellence Awards, in association with ICAEW, has sought out financial managers who exemplify the very best of the profession. In six categories, it looks to identify role model FDs and FCs – people who stand out as examples of how financial management shapes and improves British business.

Former winners of the quoted company categories include Kevin Boyd (Oxford Instruments), Eric Hutchinson (Spirent), Richard Pennycook (Morrisons), Darren Shapland (Sainsbury) and Hanif Lalani (BT).

> The awards identify people who shape and move British business

Nominations are now open in three other categories – so if you, or an FD you know, meets the criteria, now is the time to enter:

- Private company FD of the Year.
- Young FD of the Year (for FDs under 40).
- FD of the Future (in association with Ernst & Young, for an FC or other finance exec below the role of FD already demonstrating outstanding skill in financial management).

Entering is simple – just provide your name and contact details (or those of an FD or FC you'd like to nominate) by clicking "Quick Nominate" at fdx.realbusiness.co.uk. Entries must be received by 2 March 2012.

The event culminates at a black-tie dinner on 24 May at the London Marriott, Grosvenor Square – where awards will also be made to the suppliers who have provided outstanding satisfaction to FDs during the past year.

You can register your views of your banks, auditors, financial software providers and advisers – and highlight the audit partners and bank managers who have delighted you recently – at bit.ly/SatSurv

Faculty news

TOP LINKEDIN THREADS

1. Delivering change, delivering value – your views?
2. Bonuses – The good the bad and the downright ugly.
3. It isn't always the obvious metrics we need to watch.

To enter the debate join our group – ICAEW Finance & Management Faculty at linkedin.com

FINANCE & MANAGEMENT FACULTY AGM

Annual General Meeting 6.30pm on Wednesday 9 May, 2012 Chartered Accountants' Hall, Moorgate Place, London, EC2R 6EA
For full details of the AGM and elections follow the link on icaew.com/fmfagm or register your interest with norma.pavitt@icaew.com.

ANOTHER WAY TO GET INVOLVED

The Faculty Committee

We are always looking for volunteers for the faculty's organising committee. The committee's role is to set our strategy and to ensure that the advice, events, publications and technical guidance we deliver is accessible and practical. The committee meets four times a year and works mainly via email – so it's a great opportunity to get involved.

For more information please contact Emma Riddell at emma.riddell@icaew.com.

SPECIAL REPORT: COMMUNICATION SKILLS

Our latest report on communication skills features articles from experts in various aspects of communication – interpersonal skills, public speaking, sharing information and numbers, communicating across cultures and generations, and social media – providing a guide to the key issues that every accountant should be aware of. It also sets out practical tips for improving performance – from tweeting to board presentations.
To read the full report, see icaew.com/fmsr35

OUR TOP 10 STORIES OF 2011

Knowing which stories interest you most is crucial to the development of *Finance & Management* magazine – and we welcome your feedback on features we've run and ideas about what we might cover in the future. We also monitor which stories are getting the most clicks online – and the top 10 for 2011 were:

1. The seven hats of the FD
2. Turning around a finance function
3. Why – and how – lean accounting works
4. Putting the finance function and yourself on the map
5. Handling conflict in the FC role
6. Finance Function - A framework for analysis
7. How family businesses survive and prosper
8. CPD: Making your faculty membership pay
9. Assert yourself!
10. Month end reporting.

MEMBERSHIP HAS ITS BENEFITS

We want you to have access to the best value CPD, plus services that will help you advance your career. But do you make full use of everything available to you as a member of the faculty?

- Monthly magazine;
- In-depth regular special reports;
- Monthly e-newsletter;
- Free online access to any article or report published by the faculty;
- Regular events with discounted rates for faculty members;
- Opportunities to network with your peers through our LinkedIn groups;
- Women in Finance network; and
- Chance to be part of our thought leadership project.

Plus – new from 2011:

- Shorter, sharper webcasts available to watch on demand.

And remember, in a networked world, the more accountants in business who join the Finance & Management Faculty, the more value all of us get from it.
If you know someone who might be interested in joining, direct them to icaew.com/fmjoin We offer an enhanced corporate membership scheme.
Call our client relationship manager on 020 7920 8659.

Faculty events

FACULTY EVENTS

USING PERFORMANCE MEASURES TO DRIVE BUSINESS SUCCESS AND FACT-BASED DECISION MAKING
CHARTERED ACCOUNTANTS' HALL, LONDON

29 February 2012, 17.30–19.00

Imagine collecting and reporting performance metrics that really influence senior decision making. And then envisage a workplace where the data that finance professionals produce is valued and understood throughout the business.

Global enterprise performance expert and best-selling author Bernard Marr will prove that both these objectives are highly attainable. His session will provide you with a clear pathway to better performance data and more fact-based decision making. (You can find out more about how SME FDs can apply similar approaches in Stacey Barr's article on page 18.)

You'll learn about the most relevant financial and non-financial KPIs in use today; how to turn the measures into real insights; and how to present the data to engage senior leaders. Find out how leading organisations such as Google, Carlsberg, HSBC, Tesco and the NHS are using performance measures to drive tangible performance improvements.

Who should come? FDs, FCs, business analysts and CEOs.

Why? Learn how to use performance measures with impact.

More information and online booking at icaew.com/fmffebevent

WORKING CAPITAL OPTIMISATION
ASSOCIATION OF CORPORATE TREASURERS, LONDON

26 March 2012, 08.30–17.00

This comprehensive one-day course is being hosted jointly with the Association of Corporate Treasurers. Damian Pickard FCA, MCT will present techniques that can help you manage working capital and permanently improve your cash flow.

He'll be addressing the basic principles for smaller companies as well as looking at strategies that larger enterprises can employ. These will include end-to-end cash flow management, supplier financing and technology solutions.

This course involves practical exercises to apply the content to real situations.

Who should come? Financial professionals involved with managing working capital for small and large organisations.

Why? Learn how to manage your working capital for improved profitability.

More information and online booking: treasurers.org/training

WOMEN IN FINANCE NETWORK: TAKING CONTROL OF YOUR CAREER
CHARTERED ACCOUNTANTS' HALL, LONDON

29 March 2012, 17.30–20.00

Women who know what they want are much more focused and proactive in spotting opportunities. The problem is that most women are much better at knowing what they don't want.

Experienced trainer and coach Jacqui Dove – who worked at Deloitte & Touche until 2001 when she set up her own development business – will be using this workshop to encourage participants to take a bolder approach to shaping their own future. It will create time and space for them to reflect and explore both positive and negative influences on their development – and determine what is really important to them.

Participants will set both short-term and long-term goals and make sure that the outcomes are well articulated. After this session, participants will be able to look at their career objectively, consider what they want from work, and identify effective career strategies that work from them.

Who should come? Women in business.

Why? Learn how to shape your own future.

More information and online booking: icaew.com/wifmarchevent

OTHER EVENTS

MANAGEMENT ACCOUNTING RESEARCH GROUP (MARG) CONFERENCE
LONDON SCHOOL OF ECONOMICS, LONDON

22 March 2012

The annual MARG conference highlights some of the latest thinking in the management accounting field. Leading finance professionals and academics will present on this year's theme of 'Management Accounting Leadership: Global challenges – Local Responses.'

There is also a buffet reception on the evening of the conference – and some accommodation is available in LSE halls of residence. Tickets are available free, but on a first-come, first-served basis.

Who should come? Senior finance professionals looking to stay in touch with recent thinking in the field.

Why? To develop an understanding of the current state of management accounting from both practical and theoretical perspectives.

To request an invitation or submit a paper please visit lse.ac.uk/accounting/news/MARG/home.aspx or email R.J.Baker@lse.ac.uk

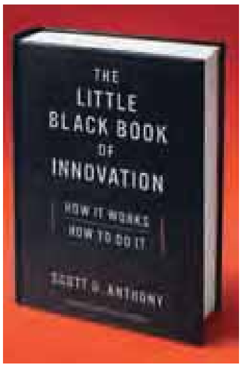
Further information about all the above events/webinar can be found at icaew.com/fmevents

Book reviews

INNOVATIVE THINKING

According to Scott Anthony, "You don't have to be Steve Jobs to succeed at innovation." A bold claim of course, but Anthony, managing director of Innosight Asia Pacific and the author of 2009's *The Silver Lining*, knows a thing or two about mastering the skills of innovative thinking. Where he excels in *The Little Black Book of Innovation* is in providing demonstrable frameworks and mechanisms for readers to apply their back-of-an-envelope pipe-dreams into something much more tangible.

It's an accessible read throughout and the sections dealing with Anthony's own back story – including post mortems into failed projects – are particularly engaging, but he is at his best when vividly bringing to life useful, imaginative methods that the reader can use to flex their own innovation muscles. Techniques such as associational thinking and using the 'Hollywood pitch' (think how the movie *Speed* might have been successfully pitched as "*Die Hard* on a bus" to tantalise Tinseltown investors looking to cash in on a novel twist to an already successful formula).



The Little Black Book of Innovation: How it Works, How to Do it

By Scott D Anthony
Harvard Business Review Press
RRP £16.99

The main weight of the book is a 28-day programme for mastering innovation's key steps, notably finding insight; generating ideas; building businesses; and, strengthening innovation prowess in your workforce and organisation. It is an entirely pragmatic way of mapping out the real potential behind an idea and one would suspect that the late, great Steve Jobs would rather approve.

REVIEW CHECK

"Scott Anthony has demonstrated a rare ability to translate academic research and cutting-edge fieldwork into eminently practical guidance.
The Little Black Book of Innovation *is an essential guide that will help anyone whose focus is innovation and growth."* - Clayton M Christensen, best-selling author and Harvard Business School professor

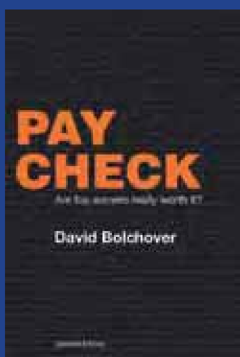
WHEN IS ENOUGH TOO MUCH?

"All right mister, let me tell you what winning means", the legendary American football coach Vince Lombardi once remarked. "You're willing to go longer, work harder, give more than anyone else." Sporting analogies are liberally scattered throughout the new and updated edition of David Bolchover's well-received 2010 tome *Pay Check*. Management writer Bolchover, author of *The 90-Minute Manager* and *The Living Dead*, wastes no time in comparing the bloated salaries of football players with those of top executives.

He manages to argue, succinctly and persuasively, that it will always be hard to justify that top earners in any discipline are "really worth it" because "it takes a great leap of faith to attribute success to the abilities of a single individual or team at the top". It's a compelling point and Bolchover is adamant that, while companies and markets must acknowledge the "self-sacrifice and iron self discipline" of individuals, the business world is still failing to confront the root cause of the issue.
This Bolchover logically identifies as a self-serving "talent myth" that seeks to justify sky-high salaries on the basis that individuals possess "extraordinary abilities without which no company could hope to prosper".

Pay Check: Are Top Earners Really Worth It?

By David Bolchover
Coptic (updated edition)
RRP £11.99



Bolchover's point is that these claims are not only unfounded; they are show a flagrant disregard for free-market capitalism. His aim, which is eruditely and always passionately voiced, is to win the system back for those who genuinely take risks in business, whilst exposing those who merely try to snatch the rewards and bask in the glory. The anti-capitalist Occupy Wall Street movement and the St Paul's protest camps aiming to stop corporate greed, both of which have stubbornly refused to move out of the spotlight since Autumn 2011, bring these claims into sharper focus and make Bolchover's updated edition especially timely and pertinent.

REVIEW CHECK

"There is, in my view, no better writer on the modern workplace than David Bolchover. With this book, he has done it again." -
Daniel Finkelstein, chief leader writer at *The Times*

"A thoughtful, persuasive and well-written book... a timely and powerful contribution to the debate. I commend Bolchover's work to anyone who cares about the future of capitalism." -
Luke Johnson, *Financial Times* columnist and entrepreneur

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The seven hats of the FD

GETTY IMAGES

Over the past two issues, we've looked at five distinct roles an FD must play in any organisation – from being a co-pilot to the CEO, to an engineer tending the machinery of business. **Richard Young** rounds out the seven hats series with perhaps the most dramatic roles – rescue service and muse

WHAT ARE THE SEVEN HATS?

STORYTELLER
Creator of a coherent narrative for internal and external audiences.

CO-PILOT
Partner to the CEO with a complementary skill set.

MAGISTRATE
Arbiter of disputes and enforcer of the law.

CONSIGLIERE
Trusted counsel offering advice at the highest level.

ENGINEER
Master of processes and systems, architect of business models.

RESCUE SERVICE
Identifier of problems and presenter of solutions.

MUSE
Promoter of fresh thinking and value-enhancing decisions.

In times of trouble, people seek refuge in cold hard facts. If the wheels are coming off, you want to know that a real expert – a disciplined, experienced, knowledgeable manager – is at the controls. Just ask the people of Italy and other European states currently run by teams of technocrats.

That means a finance director (FD) has to be capable, and brave, enough to step into difficult situations calmly and decisively. Richard Pennycook, CFO of FTSE 100 supermarket chain Morrisons, explained the storyteller hat in December's issue. But as a seasoned turnaround FD, he's also clear that finance leadership is crucial to rescuing tough situations. In other words, the FD has to be able to provide a rescue service.

"In a turnaround, it can be more complicated because you don't always have all the facts to hand," he says. "In a steady-state business, each audience expects you to be able to articulate exactly what's happening. In a rescue situation, without all the answers, you simply have to be as open and honest as possible. You can't shy away from difficult messages."

And it's not just during extreme situations, such as the one faced by Andrew Lewis when he was drafted in as a rescue service FD to turn round Avon Rubber's £4.3m loss in 2008. As Stuart Bridges, CFO at insurer Hiscox, puts it, "A large part of any senior job is being a firefighter. You're there to prevent things going wrong and to do something about it if they do. You have to be sure the ship's heading in the right direction."

Steering the ship in the right direction? That brings us to the final hat: muse. Finance is not always seen as a creative role, but it has at its fingertips the analysis and insight to make a huge difference to the way a business is run. That's evident in the contribution many FDs make to strategy.

But there's also a more fundamental shift going on. Our muse Siva Shankar, former corporate finance director at real estate giant SEGRO, calls it a shift from accountants who are good business people to business people who understand finance.

It's a change that's been noticed from the other side of the fence. BSkyB director of marketing strategy Danny Russell says, "Sky does have a very involved finance function. They're often driving initiatives, not just evaluating them. It's a very accountable company and finance colleagues here are very adept when it comes to discussing marketing."

These two hats round out our tour of the role of FD. But it's important to bear in mind two things. Colin Bramall, CFO of James Hull Associates, says there are other non-financial roles – perhaps subsets of one or more of the hats – that FDs need to play. "One hat I often wear in private equity roles, for example, is that of salesman," he says. "Private equity investors only get involved when there's a clear path to exit, so from day one you're looking to present the business in the best possible way." It's a refinement of our storyteller hat – but an important one nonetheless.

> Finance is not always seen as a creative role, but it has at its fingertips the analysis and insight to make a huge impact on a business

Bramall also points to something every FD we've interviewed for this series has stressed from the outset. "There's a bit of all the hats in every FD. Often the weighting we apply to particular roles will depend on circumstances," he says. "And the roles intertwine – for example, that of magistrate leading into that of muse."

With the support of an effective finance team – a great financial controller, in particular, to free them from the day-to-day requirement to deliver timely, accurate and pertinent numbers – any FD can live all these roles. But the one defining attribute for a modern FD has to be flexibility. The ideal is an open-minded finance leader, willing to apply their analytical mind and decisiveness to almost any situation – and able to wear as many hats as required.

THE RESCUE SERVICE

The FD's policing role has always been important. But the job is no longer just about enforcing discipline and saying no. They must take their cues from all the emergency services, taking control of situations and delivering solutions to seemingly intractable problems.

Most of the seven hats derive from the fact that the FD sees deep into any organisation at a highly granular level of detail. That depth of understanding is rarely more important than when a business is in trouble.

Avon Rubber's Andrew Lewis took up his post at the 116-year-old £100m quoted company soon after the collapse of Lehman Brothers, at a time when the business was hitting a dangerously low point. "The September 2008 group results were going to show a big loss and our banking facilities were due to expire in the November," he explains.

What followed was a textbook turnaround. Lewis and the board built fresh relationships with the group's banks, addressed working capital issues, restructured the balance sheet and redesigned the company strategy. Painful decisions about costs were balanced with new investment in sales and production capacity.

The turnaround momentum has continued – and Lewis was named Young FD of the Year at the 2011 FDs' Excellence Awards, in association with ICAEW.

He says finance has a unique role in that kind of emergency. "You tend to be able to see the burning platform more clearly than most. The analytical side of your training and temperament enables you to work through the problems and come to the right conclusions. Then you need to be able to explain the problem to other stakeholders," he says.

There's a good reason why FDs tend to be alert to emergencies. "Financial problems are usually just the culmination of issues elsewhere in the business," says Lewis. "When a business is struggling you have to

> "You tend to see the burning platform more clearly than most. The analytical side of your training helps you work through the problems"

Andrew Lewis
The group FD at Avon Rubber, our emergency service, is also 2011's Young FD of the Year

Siva Shankar
Former corporate finance director of SEGRO

tackle the right areas. You can't take a scattergun approach, you can't try to tackle everything at once. That means getting to the heart of the matter."

It also means the FD can't just fix the finances. (As James Hill Associates' Colin Bramall pointed out in relation to the magistrate role in our last issue, "People expect the FD to be able to pull a few rabbits out of the hat when things get tight – and usually we can.") Like an emergency responder, it's not just a question of giving medical help. You have to find the victim, put out the fire, secure the scene and then save lives.

Even with that requirement to take a holistic approach, speed is of the essence. "In many turnaround situations, the solutions are quite obvious," says Lewis. "But the process of internal debate about the best course of action drags on. Finding the perfect solution might take you a year. That's no good – aim for the 90% solution delivered immediately, and the result will almost always be better."

That echoes Hiscox CFO Stuart Bridges' point about the consigliere role (also in last month's issue): a good FD must be able to convince and cajole using their gut instinct as well as have a great feel for the available data.

A good emergency responder must also exude authority, adds Lewis. "However difficult the decisions, however fast you act, you also need to be open and communicate well with people, take tough decisions but keep people in the loop. Employees fear uncertainty more than almost anything else."

The final aspect of the rescue service hat is to have an eye on the long game – no matter how extreme the situation or intractable the problem. "Having that clear long-term goal and being able to show how today's decisions are helping lay solid foundations is crucial," Lewis says. "You need to be able to do that internally and keep shareholders in the loop. When you're going to them every six months, you can show how well you're delivering against the plan.

"Having had to get my hands dirty at the outset, I feel I know much more about the moving parts of the business than if the big jobs at the beginning had been squaring away the accounts and worrying about the annual report," Lewis adds. A reminder that sometimes even the best FDs benefit from being forced to wear the hats that don't look so comfortable.

THE MUSE

Creativity isn't the first word that springs to mind when you think about the FD. But for many, inspiring people both within their teams and around the business to innovate and explore is a fundamental part of the role.

Inevitably there are times when some of the seven hats are more important than others. But it would be wrong to assume that tough times mean an FD can

SHUTTERSTOCK

ignore the ones with less emphasis on discipline. "One of the principal strengths of a business in an economic environment like this is the ability to flex," says former SEGRO FD Siva Shankar. "The CFO ought to be able to help the business achieve this."

His own take on the role of the FD – and the finance function – is that it should be focused on enabling and driving change. "Finance has linkages into so many different parts of the business," says Shankar. "It also has access to large volumes of data and broad commercial knowledge. So you can come up with the kind of insights that open up the minds of other people. You can trigger out-of-the-box thinking."

That means this role complements the consigliere hat, which is all about being a trusted sounding board. But it takes the idea a stage further.

"I was talking to a head of risk recently who was wondering how they put processes in place to catch black swan events that could floor the company," says Shankar, referring to trader-turned-writer Nassim Nicholas Taleb's term for unexpected catastrophes.

"Finance can come up with the kind of insights that open up the minds of other people. You can trigger out-of-the-box thinking"

"But who's keeping their eye on the white swans?" adds Shankar. "Who's monitoring the big opportunities? If you miss them, it won't affect the company now. But in 10 years' time, it could mean a major loss in competitiveness. The CFO has to be alive to positive risks." He's quick to point out that no FD can ever forget the bottom line – and in many corporations over the past decade, problems have perhaps been caused by finance leaders who have done just that.

"If you don't have the foundations, you'd be applying creative analytics to unreliable data – and you'd come up with insights that are wrong," Shankar points out. "That loses you credibility. You need to get the foundations sorted. Ideally, you'd have someone working for you whose role is to be on top of that while you move over to spending 80% of your job being a strategist, a catalyst, a facilitator."

And, of course, one way to develop a financial controller or analyst team like that is to play the muse within your own function. Shankar has a couple of techniques to make this happen. "Part of our weekly finance session was externalisation," he says. "I gave an article to every member of the team on economics, sector-specific developments, strategy, HR, marketing – anything really. Their job was to digest it, then hold the floor for three minutes – although it could turn into a longer Q&A session – and synthesise what they read for the rest of the team. Initially I was worried people would look at this as a chore. But they were hungry to develop new ideas they could infuse into their work."

Shankar says his team found their own roles much more exciting and meaningful when the company, and their actions, were placed into the context of the wider world. That's critical if your smartest people are going to remain engaged.

"I also find that these fresh, outside ideas trigger much more left-field thinking in the team. That just wouldn't percolate through in an insulated environment. That's the thing in corporate cultures: people need to have more courage to say the things that might seem stupid."

Perhaps this sounds like a counter-intuitive thing for a finance leader to say. But as they become finance-enabled business people, rather than business-oriented accountants, it's their ability to be that kind of muse that enables them to add value both inside and outside the finance function. ■

• *Previous Seven Hats articles can be found at icaew.com/sevenhatsdec (F&M 194) and icaew.com/sevenhatsjan (F&M 195)*

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ALEX WILLIAMSON /IKON IMAGES

Weapons of mass construction

Financial instruments have been blamed for many of today's financial ills and are seen as the preserve of large corporates. But, says **Gerry Milligan**, SMEs can also successfully utilise these products

The concept of financial instruments was thrust into the popular consciousness when Warren Buffett described them as "financial weapons of mass destruction" in 2003. He was describing those instruments which, even if they didn't go on to cause the financial crisis in 2007, certainly amplified its effect.

But the term equally applies to more benign financial assets and liabilities, including bank debt, cash deposits and equity securities. And while the period from 2000 to 2007 was one of low inflation – with little volatility in the sterling/euro market and steady interest rates, arguably requiring few protective measures – the picture is quite different today. While interest rates are low, they are expected to rise in the coming years and exchange rates are volatile.

Some financial instruments are proving to be of benefit to SMEs, protecting them against foreign exchange and interest rate risks that could threaten a business's survival if not effectively controlled.

FOREIGN EXCHANGE RISK

Unpredictable currency markets pose obvious risks to companies engaged in international trade. Adverse movements in exchange rates will result in margin erosion and perhaps losses. These risks can be managed in a variety of ways.

■ **FORWARD CONTRACTS** These agreements fix the rate of exchange between two currencies for settlement at a future date. They provide certainty

"Effective risk management will provide greater control over bottom line profitability, allowing managers to focus on running the business"

around revenues and costs, and hence profitability – assuming that the underlying commercial transaction is completed. They also facilitate accurate budgeting.

It is not generally necessary to pay a fee for a forward contract to be arranged and, given a liquid market, banks will quote prices even for modest amounts.

CURRENCY OPTIONS These give the holder the right but not the obligation to buy or sell currency at a pre-determined price for settlement at a future date. That right is conditional on the payment of a premium, usually up front. Currently, a company wishing to purchase a three-month option to buy US dollars against sterling at a chosen rate (the strike rate) of 1.5360 (the current spot rate) would pay a premium of 2.06% or £6706.* The premium payable for six and 12-month periods is 3.21% and 4.89% respectively.

Premiums payable are not a constant and will be determined by, among other things, the degree of market volatility at the time the option is purchased. The minimum transaction is about £100,000.

While providing protection against adverse currency movements, currency options allow the holder to benefit from favourable exchange rate movements. They are often used when there is no certainty around completion of an underlying commercial transaction – for example, where a tender requires inclusion of firm pricing in a foreign currency but there is no certainty of outcome.

Currency options contrast with forward contracts, which must be settled at maturity. This potentially leaves the company exposed because it may have purchased currency it no longer requires.

INTEREST RATE RISK

Management of interest rate risk is of particular relevance to companies that rely on debt to finance their activities. Risk mitigation instruments include the following;

INTEREST RATE SWAPS These contractual agreements fix the interest rate on all or part of a company's borrowings. The decision to fix might reflect a preference for certainty of interest expense or a view that interest rates are likely to rise.

While fees are generally not payable for these agreements, the company may have to place a cash margin – effectively a deposit – with the counterparty bank. The minimum transaction is about £500,000. In August 2011, five-year and 10-year swap prices were 1.93% and 2.89% respectively, so gross interest paid by a borrower entering into a five-year swap would be 1.93% plus the interest margin agreed within the loan facility.

Swaps may be entered into not only for fixed amounts but also for amounts that increase over time – a process known as accreting swaps – or borrowings that decrease over time, called amortising swaps.

INTEREST RATE CAPS These place a limit on the interest rate paid by a borrower. A one-off premium is payable determined by, among other things, the interest rate limit set, the duration and amount involved. A cap provides insurance against interest rates rising above the agreed limit but allows the borrower to benefit from a lowering of interest rates.

INTEREST RATE FLOORS They place a lower limit on the interest rate paid by a borrower or interest rate received by an investor. They are often sold in conjunction with a cap (see above), creating an interest rate collar (see below). As with the interest rate cap, a one-off premium is payable.

INTEREST RATE COLLARS They are created by the simultaneous purchase of a cap and selling of a floor. The motivation for acquiring a collar is often to offset the premium payable on a cap insofar as a premium is received on selling a floor. Rather than being fixed, the interest rate payable sits within a bounded range. So a cap purchased at 5% and a floor sold at 2% will result in a borrower paying, exclusive of interest margin, a maximum of 5% a year and a minimum of 2% a year. The borrowers have therefore protected themselves against rises above the cap level while retaining some of the benefits of lower interest rates.

STRATEGIC ADVANTAGE

Effective risk management will provide greater control and certainty over bottom line profitability, allowing managers to focus on running the business. While there has been much negative press around the selling of these instruments to businesses that did not fully understand the attached risk, these products can still form part of an effective risk management strategy.

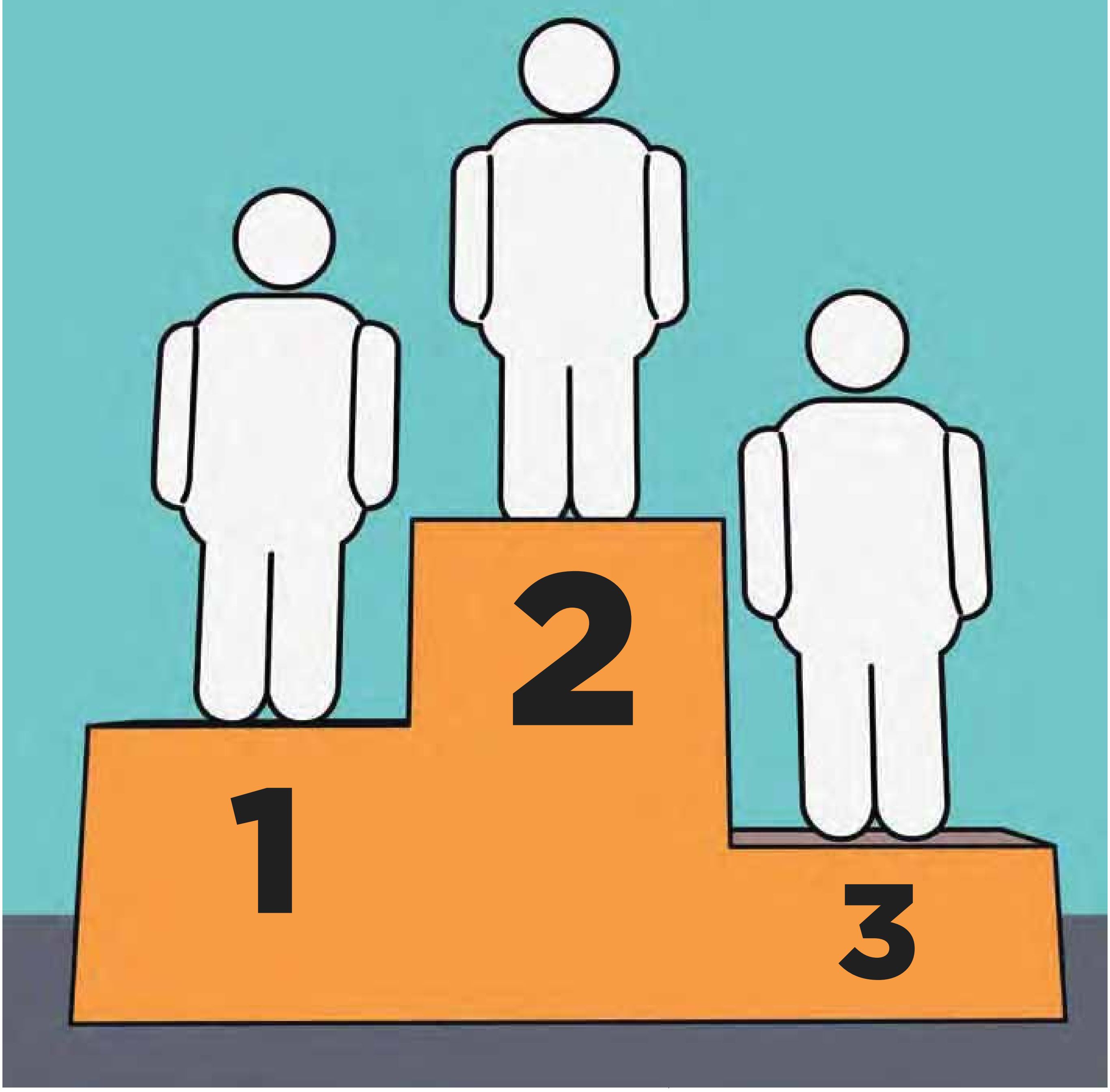
Key to this, however, is that the risks are well understood, that the instruments are carefully selected and applied bearing in mind the company's risk profile, and that transactions are undertaken with reputable and knowledgeable counterparty banks.

** US $500,000 @ 1.5360 = £325,521 multiplied by 2.06% = £6706.*

Gerry Milligan is a director of GGW Corporate Services, a specialist debt advisory business and an associate company of Smith & Williamson

Coaching to the power of two

A new form of business coaching, in which two colleagues are coached simultaneously, helps to improve communication at work and increase productivity. **Val Sampson** explains



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Business coaching is a solution many organisations have turned to when trying to improve the way staff work and the effectiveness of the business. Traditionally, the focus has been on one-to-one sessions, with a coach dealing with a client. But now dual coaching is emerging as a productive and cost-effective alternative.

Dual coaching brings two people who work together into a joint coaching session. The aim is to create a more dynamic and successful business relationship. The process provides greater clarity and a shared, solid understanding of direction and priorities. Ideally, staff will leave the session with greater awareness and knowledge of how to implement new behaviour and actions to better serve the business – and each other.

The one-to-one coaching model means a client can only act on insights gained once they have left the session. With dual coaching, the creative problem solving starts immediately, which means the session starts to become effective almost immediately.

The approach was first used in the NHS to enable health trust leaders to resolve difficulties that remained unaired at board level. Its benefits included creating more effective working relationships faster.

Since then dual coaching has been used with joint business partners, project leaders from different departments and senior managers who job share. Research indicates that it works well with line managers and direct reports as well as staff at a similar level in their organisation. Each dual coaching situation is, of course, unique depending on the issues involved. Yet common challenges arise. The following situations illustrate where the approach has worked well.

INFLUENCING UPWARDS

Two senior job-sharing managers wanted to discuss their occasionally unsatisfactory relationship with their line manager, who regularly cancelled meetings at the last minute. The coach drew attention to the fact that the communication between the two job-sharers also seemed erratic, citing agenda clashes as an example. Their schedule mix-up sent a negative message to colleagues, suggesting neither knew what the other was doing. Both colleagues acknowledged that their lack of communication was not only harming their reputations but also making their working lives unnecessarily challenging.

After discussing their current working practices, the colleagues established new ways of communicating more regularly, including inviting their comms specialist to join them in their weekly meeting.

They also devised a joint approach to the difficulties they faced with their manager, including creating a flexible agenda and a PowerPoint schedule, so they could focus her attention virtually if face-to-face meetings were cancelled. The coaching not only reinvigorated a belief in their ability to job-share effectively, they finished the process with tangible strategies for developing their working relationship, including the ability to coach each other in the future.

TOP TIPS FOR DUAL COACHING

PREPARATION
From the outset, clients should be prepared to divulge as much information as possible about their individual roles and their working relationship.

ACCEPTANCE
Both clients should be equally committed to the success of the dual coaching process.

INVOLVEMENT
Each client should be prepared to do an equal amount of work during the session and towards achieving agreed goals.

RE-EVALUATION
Both clients should be prepared to re-evaluate the ideas and beliefs they may hold about their colleague.

NEXT STEPS
Both clients should leave the meeting with a clear idea of their next steps in order to achieve goals jointly agreed during the session.

Val Sampson of Two Rivers Coaching developed the dual coaching model
tworiverscoaching.co.uk

> Research indicates the process works well with line managers and direct reports as well as staff at a similar level in their organisation

TAKING ON CHALLENGES

A chairperson and CEO began to work together after their hospital applied for foundation trust status. It became apparent in a dual coaching session that a significant member of their board was not performing as he should, and the coach raised this. By articulating what had previously been a silent dilemma for both colleagues, the coach created a powerful shift in the relationship, paving the way for the chairperson and CEO to create a solution. The board member was replaced. At the end of the coaching sessions, the chairperson and CEO reported that they had successfully and quickly created an effective working relationship.

MANAGING A TRICKY COLLEAGUE

Two partners in a successful fashion business were concerned by the imminent return of the senior, third partner after maternity leave. In her absence they had created a more open atmosphere in the office, increased profits and built new relationships with clients. In their view, they had changed the company from her kingdom to a democracy, and they were uncertain how to present this to her. By introducing a planning and thinking approach, the coach helped them to devise ways of physically changing the office environment to support equal communication. And they also decided that in future they would all take it in turns to chair meetings. Challenged by the coach on how they would avoid potential sabotage by the third partner, they agreed a new way to present their strategies which involved explaining the financial benefits and requesting input from the previously absent partner.

In one coaching session they moved from feeling they were at a two out of 10 in terms of achieving their goals for the return of the third partner, to an eight out of 10. The coaching provided a renewed sense of confidence that they could make changes in their business to the benefit of all three partners.

Face forward on performance measurement

Too many businesses use data from financial reports only to analyse what has happened, rather than to influence what could happen. **Stacey Barr** outlines how well-selected KPIs help the SME just as much as its larger counterpart

Financial reports almost always give us too little information too late when we are working out how to improve strategy or business processes. We can find out how the company did last month, but are not able to implement any change. It's known as lag information, and using it is like trying to drive using only the rear-view mirror. What we really need is lead information; the kind that suggests what the numbers might be in future financial reports if we were to take no action now.

As the driving analogy suggests, obtaining lead information isn't as simple as taking previous financial report data and using it to forecast likely future patterns. All you're doing then is seeing what the future will look like based on how it appeared in the past.

Forecasting with financial information alone ignores a treasure trove of data about explanatory factors other than the passage of time. This other kind of data is almost always non-financial, is easily collected from your business processes and will provide the valuable lead information needed to tell you how to improve them.

If we aren't happy with the way profit is trending, the solution is not to increase revenue or decrease costs. It

Forecasting with financial information alone ignores a treasure trove of data about explanatory factors other than the passage of time

is more complex and specific than that; targeting business processes, looking at how we resource them and the ways we go about generating revenue.

For example, the owner of a small boutique health club noticed revenue was in decline. The revenue figures alone couldn't tell him the reason for the dip. He could assume that it was the slow economy and that people weren't investing in their health. He could assume that the club's marketing campaigns needed a boost and so invest in further marketing. But, as you'll discover later, he'd have been wrong.

I am not trying to challenge the value of financial reports. The real question concerns the most practical use of them – and the identification of those other reports we need to plug the gaps this information was

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never designed to fill. Financial statistics help us verify the achievement of some of our financial goals, and of course are necessary to meet regulatory obligations. But they don't help us improve our business processes because they don't tell us where they are weakest or why.

Good data should give us clues about the actions needed to make them better. But a caveat is required here; "better" needs to be defined in the context of our business goals. If we go about trying to measure and improve our processes without starting with good strategy, we will end up:

- measuring too much;
- measuring the wrong things;
- wasting time and money changing business processes in ways that have little or no effect on business success.

IDENTIFY YOUR BUSINESS GOALS

When we start with clear objectives, it is faster and easier to hone in on the right lead information. We can find this by deciding which business processes have the greatest impact on the particular goal we might want to focus on now. For instance, if you decide to

A SIMPLE SIX-STEP PERFORMANCE MEASUREMENT PROCESS

1. Choose a goal you really want or need to achieve. One at a time.
2. Make your objective measurable by being clear about the performance result it implies and the evidence you would observe if its intended results were achieved.
3. Consider a range of potential measures that provide evidence of your result and choose the best one or two. There are no advantages to having too many measures.
4. Define exactly how to calculate your measure's values and be practical and realistic about the data you can obtain to create them.
5. Choose a graph that shows your measure plotted over an appropriate period of time, such as a month or year. This will enable you to more easily identify any recurring themes or patterns in performance. Investigate the causes of any patterns you see.
6. Once you have identified any opportunities or challenges, make a decision about the action required to move closer to your goal. This may mean improving business processes.

focus on a business goal around decreasing expenditure, it might be tempting to give every business process a goal of reducing spend. Yet there is such a thing as good expenditure – research and development for example, or branding. Some parts of the business probably need to increase the amount spent on that. The only kind of expenditure we'd really want to decrease is that which is wasteful, unnecessary or isn't strengthening the business. And the right lead information helps us see which parts of the business really have the greatest leverage to decrease the kind of expenditure we don't want.

If we examine which business processes can be streamlined without negatively affecting their purpose and contribution to other business goals, we can choose more meaningful ways to reduce expenditure.

Let's return to the example of the boutique health club owner. Rather than assuming that increased marketing was the solution to his dwindling revenue trend, initially he looked more closely at his business processes. He wanted to discover the causes of the decline before taking action.

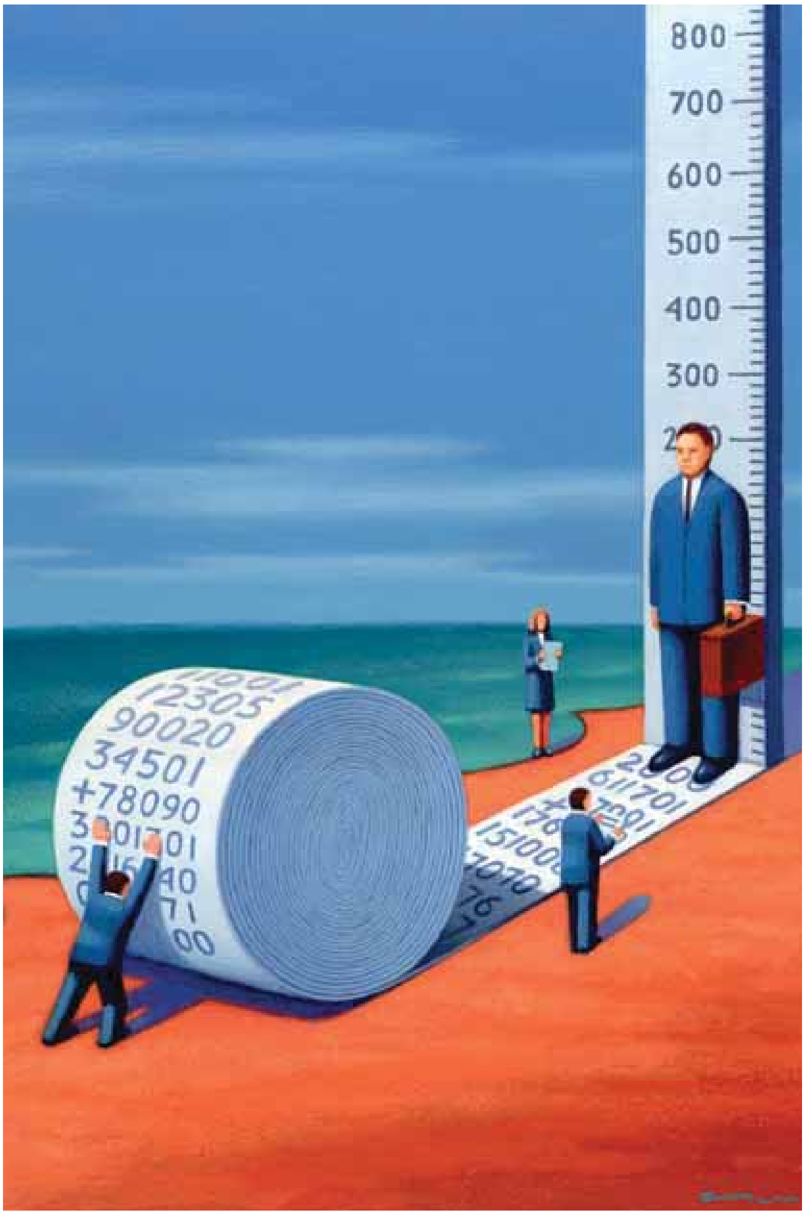
As a boutique health club, all clients had a personal training programme. There were no group classes. So revenue was directly tied to the club's total client list. What influenced that number of clients?

Certainly, marketing was important, as it would bring in new clients. But more profoundly, the retention of existing clients had a very significant impact on client numbers. There is no point spending a lot of money to attract new clients that stay for a while and then don't come back. It's much more cost-effective to attract clients and keep them.

The owner therefore constructed a few measures to help him get an objective assessment of how efficient his health club was at keeping clients. And what he saw as he plotted the average client lifespan by month was a decline that correlated almost perfectly with the decline in revenue. He also plotted by month the number of active clients, and saw a similar pattern. The business process that most influenced whether a client stayed or left was personal training, where the club's trainers worked one-on-one with the clients several times a week to help them achieve their health and fitness goals.

The owner put these charts of the average client lifespan and number of active clients on the wall in the staff room and talked to the staff. They set a target for the number of active clients and discussed how they could improve the personal training process and turn the trend around.

The staff pointed out that the new clients who missed their scheduled personal training sessions were those who soon stopped coming altogether. So



CORBIS

There is no point spending a lot of money to attract new clients that stay for a while and don't come back. It's much more cost-effective to attract clients and keep them

Stacey Barr
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the owner and staff decided to do two things. First, they measured the average number of training sessions missed per client, which became a very important lead indicator for revenue. Second, they instigated a routine to personally contact any client who missed two or more consecutive scheduled sessions to encourage them to continue pursuing their health and fitness goals and to be sure to schedule another session soon.

This insight got the owner thinking about his marketing methods. His club was not designed for people with flash-in-the-pan weight loss goals. It was designed for financially stable people who valued their health and wanted their fitness to be an integral part of their lifestyle. His marketing needed to attract this kind

THE GOLDEN RULES OF PERFORMANCE MEASUREMENT

BEWARE OF TRYING TO MEASURE TOO MUCH

You are keen and you want to find all the most important measures of success for your business – quickly. But think of it as setting out to eat a chocolate elephant; tempting, but eating it all in one go will make you seriously ill. One bite at a time is best. So when you start developing your key performance indicators, it is best to pick just one objective for your business and measure just that in the initial stages.

DON'T MEASURE WHAT DOESN'T MATTER

That the information exists, is measured by others, or just sounds interesting to measure doesn't necessarily make it worth measuring. Don't start by asking what you should measure. Instead, begin by asking what results you are trying to produce that matter enough to measure. This will put you in a much better place from the start.

BE REALLY SPECIFIC ABOUT BUSINESS GOALS

One of the greatest shortcomings of most business goal statements is that they are vague and insufficiently specific to be measured. Avoid vagueness and try to use very specific language to describe the evidence that your goal is reached and you have the results you intended. That evidence becomes the basis for what you measure.

DON'T GET HUNG UP ON DATA AVAILABILITY OR INTEGRITY

Many companies claim they can't measure something they have no data for. Put your concerns about numbers and statistics to one side, so it won't limit your consideration of the potential measures that will give you the best lead information.

DON'T DESIGN ANYONE'S MEASURES WITHOUT THEM

If you're thinking about designing measures for a staff member or a team, don't. The measures will fail unless you involve those people in the process. Do it together and they will have higher ownership of the measures produced and more buy-in to using them to improve the performance of the processes they work in, and consequently the results and impact of the business.

of client, and he knew it wasn't doing that. So he made the necessary changes.

As this example shows, having the right lead information helps us reach our business goals sooner, more easily and with fewer unintended consequences. Why? Because it highlights where processes are weakest and guides us towards the actions that can fundamentally improve them.

This is what good performance measurement is about – the most powerful means of assessment being, of course, key performance indicators (KPIs).

However, it takes time to develop good practice, and it can require some experience to find true KPIs. And the only way to get there is to get started.

MEASURING BUSINESS PERFORMANCE

Almost everyone underestimates what it takes to design and implement a really good company-wide performance measurement system. It sounds easy enough; just brainstorm some and start reporting them. But the reality is very different.

Particularly in small businesses, finding the time to work *on* the business rather than *in* the business is always a struggle. And measuring business performance, which is definitely about working on the business to improve it, is rarely deemed an urgency.

The daily whirlwind of running the business always feels more pressing; new customers to find, staff productivity to manage, customer complaints to solve and all the things that fly in from left field to sabotage your day. The irony is that reallocating some of this time to set up a few meaningful KPIs will reduce the tyranny of the urgent and help you focus on and improve what matters most. New customers will be easier to find, staff will improve their own productivity and fewer customers will complain.

The KPIs you choose need to be very relevant to the objectives of the business and the business processes that must improve to successfully reach those goals. KPIs are best when they are simple, but not simplistic, and managers and staff feel a strong sense of ownership over them.

Initially, your time and effort is best spent following a simple performance measurement process (see box on page 19). When those steps have been well practised and you have several useful measures that are helping you improve your performance, it is time to think about extending them throughout the company and to other staff members.

Finally, have a bias towards action. Treat your first implementations of performance measurement as practising, not perfecting. Let yourself learn from this and you will get great measures that give you very insightful and actionable lead information, faster.

Sustainability is the way forward

Sustainability is increasingly a factor in strategy and risk management. **Gillian Vesty** offers advice on integrating it into business decision making and weighing up the costs and benefits of sustainable initiatives

Professor Robert Simons's *Templates for Profit Planning* is an excellent tool for understanding the flow of operating profit through a business. It enables management to see whether its strategy is creating economic value by focusing them on the cash (the top wheel) return on equity (bottom wheel) and, crucially, the profit (in the middle – see figure, right). And it's also a great way to work sustainability into business planning in a disciplined and transparent way.

Simons, the Charles M. Williams Professor of Business Administration at Harvard Business School, argues that companies often pay attention to one of these wheels, and perhaps even two. But they need to consider all three. His model makes the interconnections between them clear, highlighting the need to pay attention to the whole system.

Building a profit plan with this more rounded approach is also a great way to ensure that an organisation's sustainability strategies are properly linked with shareholder value creation. The plan should involve an iterative process of projecting expected revenues minus expenses, and allocating resultant profits to the required investment in assets.

So what does that mean in practice? And how can businesses use the ideas behind the profit wheel to ensure sustainability is integrated into the decision-making process?

SALES

It's critical to make sustainability-related decisions at the start of planning any project. These plans are guided by sales forecasts, so understanding the market, and how it responds to sustainability, is important at this point. Questions that might be raised here include:

- Are your products or services marketed as exclusively sustainable?
- Do they offer sustainability benefits over those of their competitors?
- Can the status quo of sales be maintained if sustainability impacts are not embedded in your product or service offerings?
- Is the relationship between sales and sustainability readily identified – or can it be strategically created and contribute to sales growth?

Sustainability impacts and sales estimates also need to take into account macroeconomic factors, government regulation and competitor advances. For instance, the carbon footprint of your existing offerings might form part of industry-wide value chain analysis and be counted in your customers' own sustainability accounts for regulatory or voluntary corporate social responsibility (CSR) initiatives – or perhaps for their own strategic reasons.

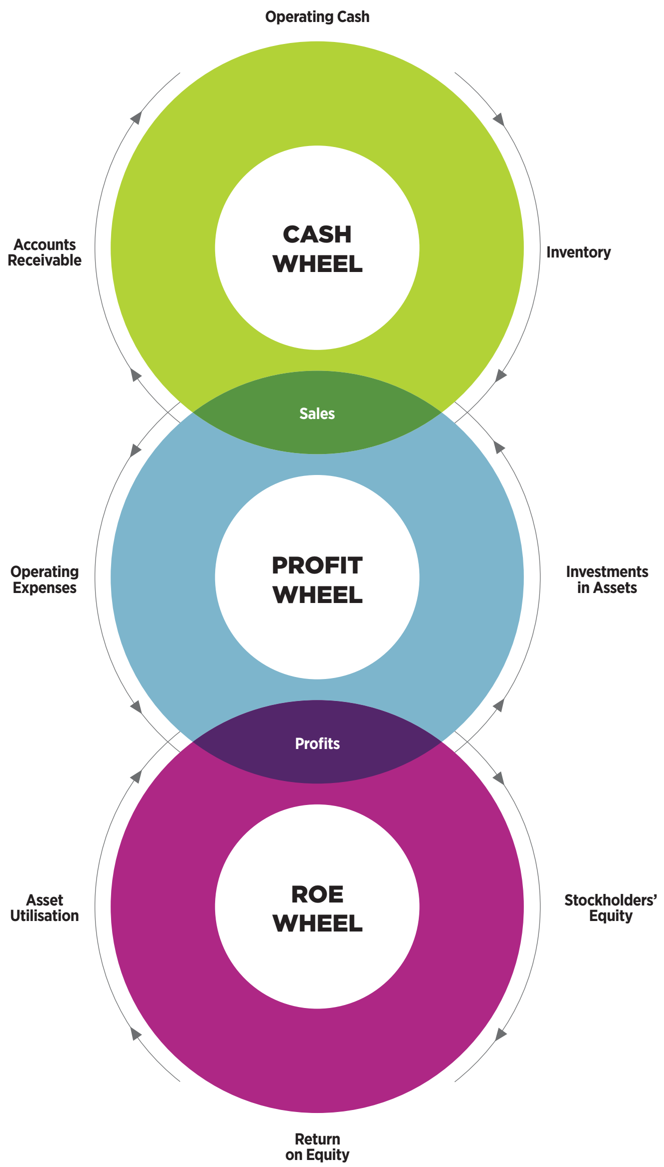
Within the food industry, for example, greenhouse gas emissions are often measured by the distance food travels from farm to plate. A typical basket of imported goods would have travelled thousands of food miles, emitting significant levels of carbon dioxide. Food organisations that measure their

PROFIT WHEEL CHECKLIST: SALES

What is material to your organisation when examining sustainability-related impacts in connection with sales?

Gains through direct investment in sustainability-related offerings or through indirect benefits that attract customers include:

- increased sales turnover due to differentiated sustainability-related product offerings;
- ability to enter new markets;
- increased sales due to improved customer relationships and satisfaction;
- other revenues through sustainability-related subsidiaries and awards. For example, benefits received from government programmes directly aimed at reducing greenhouse gas emissions.



Source: Robert Simons, *Templates for Profit Planning* Boston: Harvard Business School Case 9-199-032, 1998 in Simons, R (2000) *Performance Measurement & Control Systems for Implementing Strategy*, Harvard Business School, Boston, Prentice Hall

carbon footprint, for legislative or voluntary CSR reasons, have to measure those indirect emissions as well as the direct ones (such as pollution from manufacturing, vehicles or other sources directly under their control).

Another consideration is whether profitability can be assumed to continue with existing non-sustainable attributes. For example, Wal-Mart adopted a sustainability strategy following some negative publicity in 2005. As a result, all of its suppliers are now assessed and ranked according to Wal-Mart's sustainability assessment index to help the organisation achieve its stringent – and publicly disclosed – sustainability goals. All value-chain participants are drawn into this process if they want to continue to be an accepted Wal-Mart supplier.

OPERATING EXPENSES

To forecast sustainability-related operating expenses, it is useful to segregate costs – into variable, non-variable, committed and discretionary – when addressing each line item's potential for mitigating or contributing to sustainability impacts. (See box, Profit Wheel Checklist: Operating Expenses.)

PROFIT WHEEL CHECKLIST: OPERATING EXPENSES

What is material to your organisation when considering sustainability-related impacts around operating expenses?

Costs and benefits through direct investment in sustainability-related savings or through indirect benefits that attract customers, engage employees and satisfy legislative requirements include:

- Direct savings through monitoring energy, water, waste and direct greenhouse gas emissions.
- Indirect sustainability benefits associated with employee satisfaction; improved contracts with authorities and agencies; reduced legal compliance costs and pollution taxes through efficiency and waste minimisation efforts.
- Increased costs associated with sustainability awareness – employee training costs, internal and external services for sustainability management, research and development.

VARIABLE COSTS

So what are the sustainability attributes of each of the variable cost inputs? Questions relating to variable costs may include:

- Is your organisation capable of tracing the carbon footprint of each of the raw materials throughout the entire product supply chain?
- What are the carbon miles the product has to travel before going into your production cycle?
- How do we accurately measure the cost and associated savings of production inputs (such as energy and water)?
- Is the cost of measurement prohibiting or slowing sustainability-related change?

Remember, when identifying the potential of a linear relationship between variable costs and sustainability impacts, it is important to recognise the reputational benefit or risk associated with every decision.

NON-VARIABLE COSTS

Non-variable costs do not vary directly with the level of sales. These costs include anything from research and development (R&D) to selling, general and administration (SG&A) expenses. They might be committed, discretionary or activity-based indirect costs. Each of these operational support-related costs offers opportunities to improve an organisation's carbon footprint.

Why? Because such support activities are potentially carbon intensive. They consume electricity, purchased materials, waste disposal and business travel. When sustainability-related impacts become the cost object, the use of accounting systems such as activity-based costing (ABC) can help change organisational behaviour on a wider scale, including those support service activities.

This is why performance measures and incentives can play a crucial role across the organisation in helping it progress towards goals such as carbon neutrality. Sustainability-related activities are closely aligned with the minimisation of waste and bottlenecks in production or service cycle offerings – similar to the 'lean accounting' initiatives which are recognised as key to commercial success. In other words, by applying a more disciplined and holistic approach to sustainability, the organisation ought to reap other benefits that are well articulated using tools such as the profit wheels.

When organisations comply with volunteer programmes such as the Global Reporting Initiative (GRI), Dow Jones Sustainability Index (DJSI), or ISO standards (ISO 9001 and ISO 26000) indirect environmental and CSR costs (and potential savings) become necessary considerations.

Yet while the focus is on the readily quantifiable material sustainability costs – such as energy, water and waste – some frequently ignored benefits include indirect ones such as employee-related engagement and improved satisfaction. Managers have revealed that in their employee engagement surveys, commitment to sustainability factors ranks the highest attribute in 360° evaluations of the employer.

PROFIT WHEEL CHECKLIST: INVESTMENT IN ASSETS

What is material to your organisation when considering sustainability-related impacts ahead of investments in assets?

Gains can arise through direct investment in sustainability-related capital investments or through investment in productive assets such as plant and equipment that might also offer indirect benefits by satisfying legislative requirements and benefitting employees. Sustainability investment decisions can be strategically, legislatively or operationally driven. The benefits and costs include the following.

- Costs of sustainability-related provisions such as fines and penalties, insurance and liabilities, clean-up costs and remediation.
- Potentially greater access to capital for sustainable initiatives through government, shareholder and lending principles. Frameworks, such as The Equator Principles, help financiers recognise and manage social and environmental credit risks when evaluating potential investment projects.
- Strategic and operational costs and benefits of integrated technologies and monitoring.
- The cost of the moving baseline – for instance, in competitive environments, where decisions are made not to invest, a status quo position might not be maintained.

INVESTMENT

Working around the profit planning template, it's clear that sustainability-related sales generate profits that are reinvested in assets to generate more sales. Sustainability-related investment decisions can be made for a variety of reasons – such as legislative compliance, for operational benefits, or for wider strategic sustainability motives.

The decision to produce carbon offset beer (see Foster's case study, right), for example, would be considered more strategic in nature and would certainly require a sustainability-focused capital investment appraisal design. For FDs and other decision makers, this requires a re-think of commonly accepted best practice models.

Strategic decisions require that the following aspects be addressed:

- alignment of the proposal with sustainability strategies;
- risk in investing or not investing in the project;
- the quality of information supporting the proposal – which will require financial and non-financial input from marketing managers, sustainability managers, engineers and other experts;
- sustainability-related capabilities of people involved in operationalising the project;
- the course of action if the project does not succeed. This will include an understanding of the costs and feasibility of reversal and any impact on reputation.

INVESTMENT APPRAISAL

And, of course, there is the question of appraisal for sustainability-related investment decisions. That throws up several important questions.

- Will traditionally accepted discounted cash flow (DCF) methodology and net present value (NPV) calculation capture all sustainability aspects of the investment decision? Or should alternative methods, that include multi-criteria decision-making or full life-cycle costs and benefits, be considered? (Some companies prefer to include externalities rather than ignore such risks in their decision-making processes.) This includes considerations around a product's design, consumer purchase and end-of-life disposal. Issues such as packaging, landfill and recycling potential are included in life-cycle analysis, even once control is relinquished.

- How easy is it to measure and include the more subjective sustainability-related costs and benefits (and risks) in cash flows, particularly where investments are of a strategic nature? Foster's carbon neutral beer investment would have been considered 'strategic' with competitive, market-related benefits that are often difficult to model in traditional DCF models. Revenues associated with branding and moving baseline concepts are often hard to quantify in such decisions. For example, what does the decision to 'not invest' mean to existing cash flows? How easy is this to measure?

- Over what time frames should the impact of sustainability-related issues be considered? Investment decisions calculated on relatively short-run cash flow analysis (such as a three- to five-year time frame) could potentially ignore long-run material costs (externalities) relating to the planet's ecosystem. (There is much more detailed information on this aspect available in *The Economics of Ecosystems and Biodiversity* – TEEB – interim report, which was published in 2008.)

- Finally, would projects that traditionally offer lower, or even negative, net present values look more favourable when all sustainability-related benefits are included in the decision-making processes? The role of qualitative data is becoming increasingly important in considering these types of investment decisions.

While there is demand for external input – particularly from sustainability managers equipped with the knowledge of alternate value models and systems – there is also a need for accountants to embed knowledge of these designs in their own repertoire of expertise.

NEXT MONTH

Clearly, then, applying a holistic approach suggested by the Profit Wheels can make a big difference to the ways sustainability is handled by any organisation and evaluated by the finance function. Once this wheel is closed and the key sustainability-related assumptions are tested, the implications on available cash flow and return on equity need to be examined in more detail.

We will look at the implications of sustainability-related returns for managers and investors in the second part of this article next month.

Gillian Vesty
Senior lecturer, RMIT University Melbourne

CASE STUDY: COMPETITION FOR 100% CARBON OFFSET BEER

Several large Australian brewers decided to launch low carbon footprint beers to complement their existing product range – and within months of each other.

Foster's claimed its Cascade Green beer offered 100% carbon offsets. Working to an Australian Greenhouse Friendly certification initiative, all aspects of Cascade Green's production cycle were reviewed for potential carbon emission savings. Foster's invested in operational efficiency programmes, with lightweight glass bottles, 100% recycled cardboard and biodegradable vegetable inks used to minimise carbon emissions on packaging.

By linking this initiative to the profit-planning wheels, the brewers established they could achieve greater sales on their new product by attracting sustainability-aware customers. The extent to which the rigorous greenhouse gas certification would impact on potential sales was part of their initial planning processes. But in estimating sales, they also needed to be aware of competitors' similar products – and the impact of their own new product on their existing product mix. All their carbon offset claims required full audit to achieve certification.

As Foster's management has observed, for the carbon offset beer product to be marketed as 'sustainable', the low carbon footprint claims required are:

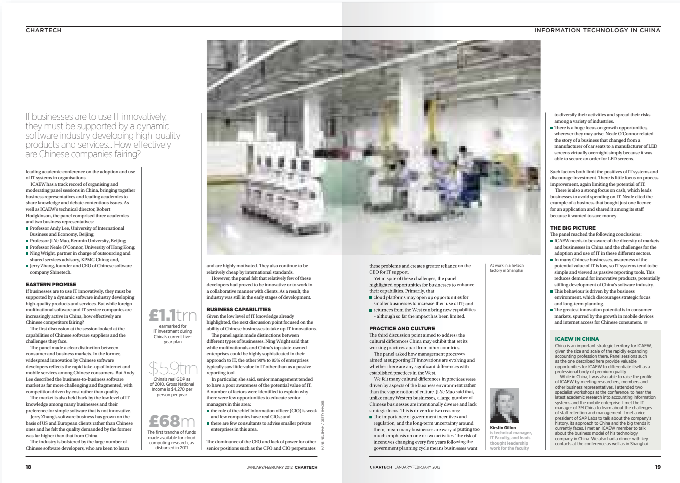
- total operating costs and investments to be isolated and attributable to this product line only – including water, energy and all variable materials and overheads;
- all working capital, productive assets such as plant and equipment to be identified and isolated from other balance sheet items;
- the organisation's sustainability manager to be involved throughout the accounting planning, costing and decision-making processes; and
- certified offsets to be purchased in credible community projects approved by the Greenhouse Friendly Programme.

The implications of this innovative product offering can be seen by tracing decisions though each of the three wheels. So the success of this initiative would be recognised in increased levels of sales and margins (through new brand recognition and pricing power) and reduction in costs (through energy, waste and other lean initiatives). Likewise, the success of the investment would be acknowledged through improvements in shareholder value.

Foster's believes that this project has, indeed, aligned shareholder interests with the goal to reduce the group's overall global greenhouse gas emissions.

From the faculties

Round out your reading with the pick of the features from ICAEW's other faculty magazines published this month



CORPORATE FINANCE

TURNAROUND FOR TURNAROUND SPECIALISTS?

Economic downturns usually offer good opportunities for investors to buy assets cheaply and create real value by effecting turnaround for stressed companies.

This recession has been different though and for turnaround specialists activity has been surprisingly slow. This is down to a number of reasons. Financial management in businesses is generally better than in the past so companies have dealt with the issues that would otherwise spell insolvency.

Low interest rates have meant that banks have been able to give payment holidays, allowing businesses to simply service the interest on the debt. And, unlike in previous downturns, where the banks have found themselves in control of distressed companies, they have made the decision not to sell them on, largely because there is too much bad debt and not enough capital to shift it off in write-downs.

Private equity firms and corporates are also reluctant sellers, especially when they perceive poor EBITDA multiples to be a sign of macro-economic conditions.

Yet it's not all doom and gloom for turnaround specialists. Over the last year, both corporates and banks have started to use them to fix problems in situ and, while nobody is predicting a huge upturn for them in 2012, there are good opportunities on the horizon for bold companies.

For more from the Corporate Finance Faculty at icaew.com/cff

CHARTECH

B2B IT INNOVATION IN CHINA

A gap in China's B2B IT development could present consultants or developers with opportunities – if they can negotiate the hurdles. The Chinese B2B software market is fragmented, with competition driven by cost rather than quality. The majority of enterprises (outside of state-owned or multinational firms) have little IT knowledge. Businesses prefer simple rather than innovative software and see little value in IT other than as a passive reporting tool.

These attitudes have hindered innovation and growth in the domestic B2B software industry, which is still in the early stages of development. This is in contrast to China's successful mobile and internet software development scene, driven by consumers.

Among factors that inhibit a swift change in business attitudes are:

- governance (dominant CEOs disempower senior management, including undervalued chief information officers);
- a strong focus on cash, which discourages an IT investment approach; and
- government regulation.

Uncertainty and risk around the government planning cycle leads companies to diversify to spread risk or seize short-term growth opportunities. The resulting lack of strategic focus limits the value gained from IT systems and discourages long-term investment.

Find out more about the IT Faculty at icaew.com/itfac

AUDIT & BEYOND

HUMAN TOUCH IN AN AUTOMATED WORLD

Companies are now taking advantage of developments in technology to produce financial and non-financial data which is available in real time to their employees – and audit is failing to keep up.

The way audits are carried out hasn't changed significantly in a number of years. By default, auditors use electronic information held within the client company's database, print it off, manually check it against source documentation (in many cases also in electronic form) and then manually input it into whatever form of audit software they have chosen to use.

What is needed are computer assisted audit techniques (CAATs) – tests that auditors can apply electronically to the company's data. These would allow auditors to:

- test the entire dataset, rather than sample the data;
- look at transactions over the year, not just at a point in time;
- profile data; and
- test Excel spreadsheets.

Not only can CAATs simplify and automate the audit process, they can take auditors beyond the traditional audit to wider assurance offerings. However, they won't ever be able to replace thought and common sense. Scepticism remains a necessity in an electronic world.

Find out more about the Audit & Assurance Faculty at icaew.com/aaf

Technical updates

Our regular round-up of legal and regulatory changes

PENSIONS

An update from our Ethics, Law and Governance Department.

THE PPF LEVY IS CHANGING

The Pension Protection Fund (PPF) is changing the way that it calculates the levy charged to defined benefit (DB) pension schemes, as well as introducing a number of alterations to the way it handles data from schemes. If as an employer you sponsor a DB scheme, or are involved in one, there are actions you may wish to take before the end of March to ensure your scheme pays the right amount for 2012/13.

Key changes include:

- The PPF expects to keep rules fixed for three years, to help predictability.
- Data supplied by schemes up to 31 March 2012 will be used for 2012/13.
- The risk of the scheme sponsor failing will be averaged from data on the last working day of each month.
- To assess scheme funding, PPF will smooth asset and liability values provided to them, using market indices for the last five years.
- Scheme investment risk will be taken into account – with an option for schemes to self-report investment risk.

The changes follow consultation and are expected to result in levies that are generally more predictable, more stable, and more aligned to factors within the control of schemes and their sponsors. Levies will, in total, be the lowest the PPF has set, at £550m for 2012/13.

More information on what is changing and what practical steps schemes and their sponsors can consider is available from the PPF website. www.pensionprotectionfund.org.uk/newlevyframework/Pages/newlevyframework.aspx

TAX

News and updates from the Tax Faculty weekly newswire.

ALTERNATIVE DISPUTE RESOLUTION

ADR provides a mechanism to see whether issues preventing agreement on a dispute can be resolved without the need to go to a tribunal. During 2011 HMRC piloted ADR to see how it could improve the way it resolves tax disputes for SME customers in North Wales and NW England – the results were encouraging: 60% of disputes were either fully or partially resolved to the satisfaction of both customer and HMRC.

HMRC now plans to test ADR more widely among SME customers – and at an earlier stage in the compliance check process. But it is restricting availability of ADR to cases where an appealable tax decision or assessment has not been made. Cases that are potentially suitable for the pilot may involve any of the following features:

- facts which are capable of further clarification;
- disputes that may benefit from obtaining more suitable evidence;
- fact and/or technical matters in which there is legitimate scope for any party to obtain a better understanding of the other's arguments;
- issues which are capable of further mediation and settlement by agreement within the framework of the Litigation and Settlements Strategy.

CODING NOTICES

"Are you still receiving your employee PAYE coding forms on paper?" HMRC asks. It is encouraging employers to receive forms P9 and P6 (notice of the tax code to use for an employee) electronically rather than on paper. "Once you register for HMRC's PAYE Online for employers service, HMRC will automatically stop sending you forms P9 and P6 *Notice of the tax code to use for an employee* by post and will automatically send them to you online," it says.

R&D TAX CREDITS

The Northern Ireland Corporate Tax Office – part of HMRC – has produced an attractive, easy-to-follow guide to R&D tax credits, *Your research Our support*. The system is the same as in the rest of the UK so it will also be useful to companies in other parts of the UK – and it includes some helpful examples at the end.

The only aspect that is different outside Northern Ireland relates to EU grants which will not be available in all parts of the UK. The report can be downloaded at hmrc.gov.uk/nircto/invest-in-ni.pdf

VAT ON EXTRA CARE ACCOMMODATION

Construction businesses, take note. HMRC has issued

Revenue & Customs Brief 47/11 to clarify its view of the VAT liability of the construction and first sale of dwellings that are linked to a separate provision of care ("extra care accommodation").

For the purpose of this Brief, HMRC defines extra care accommodation as self-contained flats, houses, bungalows or maisonettes that are sold or let with the option for the occupant to purchase varying degrees of care. It does not apply to accommodation where the occupant needs care or supervision typically provided by an institution.

HMRC accepts, regardless of the Use Class determined by the planning authorities, that extra care accommodation is "designed as a dwelling", and therefore its construction and first sale (or long lease) will be zero rated for VAT, if

- the dwelling consists of self-contained living accommodation;
- there is no provision for direct internal access from the dwelling to any other dwelling or part of a dwelling;
- the separate use of the dwelling is not prohibited by the terms of any covenant, statutory planning consent or similar provision;
- the separate disposal of the dwelling is not prohibited by the terms of any covenant, statutory planning consent or similar provision;
- statutory planning consent has been granted in respect of that dwelling and its construction or conversion has been carried out in accordance with that consent.

HMRC TO REVIEW BUSINESS RECORDS CHECKS

The HMRC's Business Records Checks (BRC) project is designed so that an HMRC officer can visit a business, look at the records and see whether they are adequate for producing tax returns. HMRC has been piloting BRCs since spring 2011.

The Tax Faculty and other tax representative bodies have been concerned about BRCs from the beginning. While we support initiatives to help businesses keep good records, we are not convinced that the BRC approach is the best way to achieve this.

We are concerned that HMRC may set unrealistic criteria for small business records and that BRCs will place a considerable compliance burden on SMEs and their advisers (we expanded on these concerns in TAXREP 19/11). So we're pleased that following consultation with the representative bodies, HMRC has started a detailed review of the BRC project which will consider various options aimed at achieving the original objective of BRCs – dealing with poor record- keeping in the SME sector. We are keen for feedback from members who have been targeted in the BRC pilot. Please send them to jane.moore@icaew.com

IHT BUSINESS PROPERTY RELIEF AND GROUPS OF COMPANIES

At the end of last year the Tax Faculty published TAXGUIDE 5/11 Inheritance tax – Business property relief and groups of companies to provide some guidance on the practical application of the business property relief (BPR) rules as they apply to groups of companies. It contains some examples on the application of the BPR rules to groups of companies which the Tax Faculty's Inheritance Tax and Trusts Working Group put to HMRC.

A number of scenarios were put forward, involving Intermediate holding companies, indirect subsidiaries, dual trading and holding companies, and intragroup funding. In each case HMRC has commented on how it would apply the BPR rules. Download the guide at icaew.com/taxguide511.

FINANCIAL REPORTING

Updates from the Financial Reporting Faculty.

FUTURE OF UK GAAP

Current UK GAAP is to be replaced with a new regime based around the IFRS for SMEs. While it is envisaged that FRSSE would remain for now, these changes could affect virtually all companies in the UK. To help you keep up with the changes, the Financial Reporting Faculty is hosting a webinar on 21 February and an event on 13 March, both free of charge. See icaew.com/frf

IFRS 9 DEFERRED

IFRS 9 Financial Instruments was due to become mandatory on 1 January 2013, but not all stages of the project to replace IAS 39 Financial Instruments: Recognition and Measurement are complete. Deferring implementation to 1 January 2015 will make it possible for all phases of the project to have the same mandatory effective date.

AUDITOR REMUNERATION

The legal requirements for companies to disclose auditor remuneration in their individual and group accounts have been amended for financial years beginning on or after 1 October 2011, with early adoption permitted. As a consequence, ICAEW has published an updated technical release, TECH 04/11 Disclosure of Auditor Remuneration to reflect the changes. See snipurl.com/auditorremuneration

INCOME TAX

The ASB and the European Financial Reporting Advisory Group (EFRAG) has published a discussion paper in order to solicit views on how the financial reporting of income tax could be improved. Tax is an important expense for most companies, and transparent and complete financial reporting is complex because the tax effects of transactions do not always fall in the same period as they are reported in the financial statements. Comments are due by 29 June 2012. See frc.org.uk/asb/press/pub2685.html

IFRS 10 TRANSITION GUIDANCE

The IASB has published proposed amendments to IFRS 10 Consolidated Financial Statements. The objective is to clarify the transition guidance by confirming when an entity needs to apply IFRS 10 retrospectively. The proposals should allay the concerns of some who thought that the transition provisions were more burdensome than originally intended. Comments are due by 21 March 2012.

FINANCIAL REPORTING FACULTY IN 2012

Membership of the Financial Reporting Faculty for 2012 starts at just £105. Membership will give you full access to the faculty's wide range of resources including factsheets, webinars, monthly bulletins and eIFRS. For full details of membership benefits and information on new UK and international financial reporting standards available to all, visit icaew.com/frf

EMPLOYMENT LAW

This section is extracted from the monthly bulletin produced by law firm Herbert Smith LLP – but does not constitute legal advice and should not be relied on as such. herbertsmith.com

TRIBUNAL: WATCH THIS SPOUSE

Treating someone less favourably because they are married to a particular person is unlawful, according to a recent Employment Appeal Tribunal (EAT) decision. The claimant alleged she was treated less favourably because her husband, also an employee, was in dispute with their employer. Surprisingly, the EAT was untroubled by the suggestion that she might have been treated similarly had she been in a close but unmarried relationship with the same man.

This seems to go further than previous case law and, unless appealed, could call into question employer policies such as prohibiting employees in close relationships working together, or refusing to employ those in a close relationship with someone working for a competitor due to the risk of disclosure of confidential information. Any married employees (or those in registered civil partnerships) subjected to such policies may now be able to claim unlawful discrimination. (Dunn v The Institute of Cemetery and Crematorium Management, EAT)

TUPE DEVELOPMENTS

No service provision change where client changes.
TUPE applies to two types of transaction: transfers of a business and service provision changes. The EAT has ruled for the first time that there is no service provision change under TUPE where there is a change in the client on whose behalf the services are being carried out. This is good news for purchasers of property portfolios in particular. Until now, the cautious approach was to assume that TUPE might apply where new managing agents or other service providers were appointed by a new property owner. Now it appears there cannot be a service provision change in this situation (at least until any appeal is heard), although in some cases there might still be a transfer of a business. Best practice? Address the risk and potential costs in the contractual documentation. (Hunter v McCarrick, EAT).

The Court of Appeal (CA) has upheld the EAT's ruling that administrations are never to be viewed as "instituted with a view to liquidation", even if it is immediately clear that there is no prospect of rescuing the company as a going concern. The legal character of an administration is primarily to rescue the company and as such it cannot benefit from TUPE Regulation 8(7) (which disapplies the automatic transfer of employees to liquidation proceedings). Employees will be automatically transferred to a purchaser of a business from an administrator, including pre-packs. This will need to be factored into the commercial assessment of the deal, in particular the price, given that administrators will rarely give adequate indemnities for employment claims. (Key2Law (Surrey) v De'Antiquis, CA)

STATUTORY LEAVE: NOT BANK HOLIDAYS?

The Supreme Court (SC) has upheld a decision of the Court of Session that employers can designate periods of time where the employee is not normally required to work – such as field-breaks onshore by offshore workers or school holidays for teachers – as statutory holiday. The Supreme Court did not reach a concluded view on whether days that are part of the seven-day weekly cycle but which are not normally worked (eg Saturdays, assuming Sunday is treated as the weekly rest period) can be designated as holiday.

However, the Court favoured the suggestion that, in light of the Working Time Directive's purpose, the entitlement is to periods of annual leave measured in weeks, not days. So a worker can choose to take single days – but the employer cannot force him to do so. If correct this would call into question the practice of designating bank holidays as part of employees' statutory minimum entitlement. (Russell v Transocean International Resources, SC)

CONFIDENTIAL INFORMATION

Case law has established that it may be possible to injunct a professional adviser from acting as an expert for one party to a claim when it had previously provided services to the other side and had been given access to highly confidential information relevant to the new matter, unless it can show that it has taken reasonable measures to prevent disclosure.

In a recent case, an employer sought to extend this principle to stop an employee going to work for one of its clients on the basis that this was likely to involve her in the use of the employer's confidential information. The High Court (HC) ruled that the principle did not apply to employees, and refused to make a barring order. (Caterpillar Logistics Services (UK) Ltd v Huesca de Crean, HC)

COMPENSATION AND BENEFIT LEVELS

From 1 February 2012, the cap on the unfair dismissal compensatory award will increase from £68,400 to £72,300 and the cap on weekly pay (used to calculate the unfair dismissal basic award and statutory redundancy pay) will increase from £400 to £430.

From April 2012, the weekly rate of statutory maternity/paternity/adoption pay will increase from £128.73 to £135.45, with the earnings threshold increasing to £107 a week. The weekly rate of statutory sick pay will rise from £81.60 to £85.85.

Tax Faculty weekly newswire
Subscribe free: visit ion.icaew.com/TaxFaculty and click the sign-up link on the right.

CORBIS

SLAY THE MEETINGS MONSTER

Do you spend your time in meetings only to see no productive outcome? **Paul Sloane** explains how to better engage with your colleagues (and spot the meetings you should avoid)

Do you spend too much time in meetings? If so, you are in good company. One of the most common complaints among office workers is that their productivity is hampered by too many unproductive discussions. And futile meetings lead to frustration because they waste participants' time and undermine the effectiveness of the whole organisation.

HERE ARE SOME IDEAS ON HOW TO CONQUER THE MEETINGS MONSTER

INVITE FEWER PARTICIPANTS

The meeting should be restricted to those whose presence is essential to the process of reviewing the issue and to making the decisions. People who want to be kept in the picture should receive a summary email from the chair of the meeting. If you are invited to a discussion that you believe is not really relevant to

"Futile meetings lead to frustration because they waste participants' time and undermine the effectiveness of the whole organisation"

you or that will be poorly run, then offer your apologies and ask for a summary. You will rarely regret missing such a discussion.

HAVE A FOCUS, AGENDA AND FINISH TIME

The purpose of the meeting and any required information or preparatory work should be made clear to all delegates well in advance. In addition to the start time there should be a planned finish time. The chair of the meeting should keep in mind the agenda and quickly curtail diversions and irrelevancies. If you are invited to a meeting with no agenda, it's worth asking for clarification on both the timings and purpose of the meeting.

SEEK MEETINGS TRAINING

Anyone who chairs a meeting should have had some basic training on running them. This would include keeping to time, retaining focus, reaching decisions, agreeing actions and handling conflicts. Does your human resources department offer any guidance or a training course? If so, follow them up and encourage others to do the same.

USE A DISCIPLINE

There are various formal methods for managing meetings (Edward de Bono's *Six Thinking Hats* (Penguin, 2009) is one I like). The thrust of these techniques is to help you focus on the key activities of productive discussion and speedy, effective decision making. This method is particularly good for contentious issues because it takes the conflict out of the meeting and forces everyone to consider all the various points of view. Why not adopt such an approach at the next meeting you chair?

ASK FOR FEEDBACK

Every meeting should be quickly appraised. At the end of the meeting the chair may wish to ask, "How could we have run this meeting better?" People can respond directly or anonymously later on. Either way you will have constructive suggestions for how to make meetings shorter and better.

BAN MORNING MEETINGS

Josh Kaufman, author of *The Personal MBA: Master the Art of Business* (Portfolio, 2011), recommends that you should organise meetings for only in the afternoons, thus allowing you to reserve mornings for essential work that only you can do. Kaufman claims that this significantly improves productivity and I am inclined to believe him.

CONCLUSION

Professionals and office workers spend a great deal of time in meetings, yet rarely consider how to run them more effectively. Adopt the approaches outlined above and get the meetings monster under control in your place of work.

For more on using de Bono's Six Hats, visit debonogroup.com/six_thinking_hats.php

Paul Sloane is an author and speaker on innovation, lateral thinking and leadership. He is the founder of Destination Innovation

Strategic thinking the organic way

Managers should think constantly about how to apply and refine strategy, rather than see it as something to be planned in advance and implemented inflexibly. This, argues **Morgen Witzel**, is what the great strategic thinkers have always done

GETTY

To many people, strategy means plans, formal statements of goals and the laying out of the route by which those goals will be reached. This is sometimes called the planning approach to strategy. The principles were outlined in the 1960s and 1970s by writers such as Igor Ansoff and Kenneth Andrews, and the planning approach is still widely taught and practised today.

But does it work? The danger is that by using this approach, strategy becomes a little like a video game. If the right moves are made in the right order, the end goal will be reached and the business will succeed. But life, and especially life in business, is not like a video game. Many things happen, usually at once, that cannot be predicted and there are no pre-set or pre-determined solutions.

Critics of the planning approach argue that it robs us of our ability to think creatively. We become slaves to the plan and very often we carry on with it even when events happening around us indicate we should be doing something else. In other cases, people simply ignore the plan if they cannot understand it or make it fit with the circumstances in which they find themselves. Instead, they do what they think is best. But sometimes what they think is best

GETTY

is not what the organisation as a whole wants or needs.

Henry Mintzberg, the Canadian writer on strategy, argued that planning is something foreign to what most managers actually do. In his book *Mintzberg on Management*, he stated that planning is something that is done using the left side of the brain, which processes information sequentially and in logical order. Most managerial work, however, uses the creative, intuitive right side of the brain. He went on to argue that most planning in fact confuses managers and makes it more difficult for them to deal with the challenges they must face. Another writer, the Japanese guru Kenichi Ohmae, commented that managers who rely heavily on planning are often unable to react quickly to threats. Hidebound by the plan, they stand like deer trapped in the headlights of an oncoming car, unable to move or avoid the danger coming towards them.

The alternative approach advocated by both is a more creative approach to strategy in which strategy making and the implementation of strategy become a continuous process. Ohmae referred to this as strategic thinking, arguing that the primary task of the strategist was to think about strategy constantly, making strategic decisions as and when they were needed rather than sticking to a pre-set plan. He did not invent this concept, and indeed it has a long history in the literature on strategy.

A SHORT HISTORY OF STRATEGY

Business strategy is a curiously late invention. It really only emerged as a concept and a discipline in the early 1960s, in the works of Igor Ansoff and Alfred Chandler. But in fact, businesses have been making and implementing strategies for hundreds of years, even thousands. When they wanted to understand the concept, they usually turned to the works of writers on military strategy. Here too, there is an interesting tension between the planning approach and the semi-intuitive thinking approach.

The grandfather of all writers on strategy, the Chinese general Sun Tzu, came down emphatically on the side of the thinking approach in the fourth century BC. There are no set rules for strategy to be found in Sun Tzu's work, usually known today as *The Art of*

> We become slaves to the plan, carrying on with it even as events indicate we should do something else

War. Instead, he emphasised concepts such as preparedness and knowledge of the situation. "Know your enemy and know yourself, and you need not fear the result of a hundred battles", is one of his comments. He advised commanders to spend much of their time before a battle contemplating the situation, the resources they had to hand, the resources the enemy was likely to deploy and the environment in which the battle would be fought. Strategic decisions would then fall naturally out of this contemplation.

Two ancient Roman writers on strategy, Frontinus and Vegetius, took opposite sides. Frontinus, in his book the *Stratagemata*, advocated a planned approach. He created lists of strategic options relevant to specific situations. Readers could pick the option that suited them best and then put that idea into execution. Management consultants today sometimes still treat strategy in the same way. Vegetius, on the other hand, argued like Sun Tzu that the key lay in being prepared for any eventuality, rather than planning for a limited range of possibilities.

The same view was followed by the Renaissance writer and diplomat Niccolò Machiavelli. He has had a bad name down through the centuries thanks to his advocacy of the principle that the ends justify the means, but there is a good deal of sound thinking in Machiavelli's writings on strategy and he was widely followed right through to the 20th century. He too believed that strategy was a matter of being prepared to take advantage of unexpected opportunities. Luck, or fortuna, played a large part in human affairs, he believed, and success went to those who could recognise the moment for action and seize hold of it. It stands to reason that those individuals who follow rigid plans will be less able to react more quickly to the unexpected.

Being prepared for the unexpected was one of the major themes in the work of another early writer on strategy, the nineteenth-century Prussian staff officer Carl von Clausewitz. He developed the concept of "friction", a series of unexpected and unplanned-for events that gradually builds up to slow down the execution of a plan, or even derail it altogether. Clausewitz warned against reliance on planning and argued instead for flexible thinking. Although an army should have an overall goal in mind, the means by which it can reach that goal will change according to time and circumstance. Later German officers demonstrated the truth of what Clausewitz said. Prior to the First World War, the Schlieffen Plan was an elaborate and highly detailed plan for the invasion of France and Belgium. At first, in August 1914, all went according to plan. But gradually, unforeseen events began to build up. The Schlieffen Plan was too inflexible and could not account for these, and finally the German advance ground to a halt, beginning a bloody stalemate that lasted for four more years.

Given all of this, why did the early business writers on strategy put so much emphasis on planning? For one thing, business and war are not the same thing, no matter what some have claimed. Kenneth Andrews and others of the planned school believed business activities are governed by rational economic principles. In most well-run organisations this is true, most of the time.

THINKING AHEAD

Planning has advantages. For one thing, plans remind people of their own roles and what is expected of them. They contain timetables and budgets. So long as they are aids that help people to get things done, then they are a force for good. The danger is that they can constrain people and limit thinking and action. "It's not in the plan" is one of the oldest human excuses for inactivity.

The planning process also concentrates the mind. Properly conducted, strategic planning reminds people of their goals and purpose and helps them consider the options they have available. The planning process can also help to reduce complexities in the environment. One well-known strategy guru, Michael Porter, recommended that companies begin their approach to strategy by considering two dimensions

The key lay in being prepared for any eventuality, rather than planning for a limited range of possibilities

only. First, what market scope would suit best? Should the company take a broad approach and seek a mass market, or concentrate on niche markets? Second, on what basis would the company compete: on a cost basis, trying to undercut competitors, or on the basis of differentiation, creating unique selling points that would set its products apart from those of competitors? This kind of clarification can help people to focus on what is most important.

So long as this simplification is used as a device to kick-start thinking about strategy, all is well. Again, problems begin when people use frameworks like Michael Porter's as absolute guides to action. This is not at all what Porter himself intended. His concepts of market scope and competitive basis were intended all along as a starting point. For example, it is entirely possible for a company to compete on the basis of both low cost and differentiation. The Porter approach is merely a tool to get managers thinking.

FLEX AND STRETCH

As already noted, the opponents of strategic planning – or at least, opponents of slavish reliance on strategic planning such as Ohmae and Mintzberg – argued that the planning process is not relevant to the way that most companies function. Mintzberg in particular believed planning was a largely foreign activity. Most managers did not plan, nor did they follow plans. They spent most of their time firefighting, trying to deal with the crises and problems that beset them in their everyday lives. The best option was to develop a crafting approach, slowly working out the strategy a step at a time. In Mintzberg's view, thinking about and implementing strategy are part of the same process, just as potters determine the shape of what they will make by feeling the clay under their hands.

The idea that the gradualist, thinking approach is a natural one had been advocated earlier by Charles Lindblom in a famous article entitled *The Science of Muddling Through*. Lindblom argued that people shy away from taking big steps into the unknown because they are instinctively frightened by uncertainty. They prefer to take small steps so that they can control what they can around them and thus muddle through situations. Paradoxically, bold strategic plans that project forward into a future that is unknowable can actually increase uncertainty. Rather than providing guidance, they induce fear and concern. "How will we ever make this plan work?" becomes the commonly asked question. A later author, James Brian Quinn, took up Lindblom's ideas to create the concept of logical incrementalism. Here, as with Mintzberg, thinking, reflection and action are all combined in a series of small, incremental approaches to the strategic goal.

Key for all of these writers is the concept of mental preparedness. Just as with Sun Tzu in ancient China, the first critical factors are knowing one's own strengths and weaknesses, and knowing those of competitors. Next is the ability to think strategically, to spot opportunities as they emerge and react quickly, in the way that Machiavelli had advised. Summing up all of these ideas in his book *The Mind of the Strategist*, Ohmae likened strategic thinking to a muscle. If one exercises muscles regularly, they stay in trim and the person who exercises becomes stronger and more healthy. In just the same way, thinking about strategy all the time helps managers to both understand strategic principles and get better at spotting opportunities. To put it another way, the more managers think about strategy, the more effective their thinking becomes.

It can be hard to do this. In the words of the old phrase, "when you are up to your neck in crocodiles, it can be hard to remember that your original objective was to drain the swamp". But Ohmae's and Mintzberg's argument makes sense. A firm that spends two or three months of the year making a strategic plan and then the rest of the year trying to implement it will always face an uphill struggle. Far better to think about strategy as you do it, and keep thinking about it all of the time.

SUMMARY

Strategy is sometimes associated with formal planning, an approach which has been and continues to be popular. Strategic plans are useful in helping people focus on what matters, and can serve as a guide and reminder of what action is expected of them. However, influential, older writers such as Tzu, Machiavelli and Clausewitz, along with modern thinkers such as Mintzberg, Ohmae and Lindblom, have emphasised the need for thinking rather than planning. They argue strategy-making and execution should be seen as a continuous process, as this is more like the way people and organisations function.

- Companies using the thinking approach are said to have a more creative, intuitive approach to strategy, which encourages adaptability and flexibility.
- The thinking approach enables firms to react quickly to opportunities and take advantage of them, rather than being hidebound by the plan.
- Although plans intend to clarify, they can end up increasing uncertainty. An incremental, thinking approach allows people to proceed at their own pace and control events around them.

READ MORE

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