Finance & Management

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The monthly newsletter for members, with news, views and updates on current topics.

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND & WALES

Faculty of Finance and Management

'THE BUSINESSMAN IS THE ONLY MAN WHO IS FOREVER APOLOGISING FOR HIS OCCUPATION ' – HL Mencken

Corporate governance

As the Higgs report on non-executives is published, we assess the state of governance in the UK.
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FORTHCOMING EVENT ...

Future of finance

19 February – In this evening lecture, Scott Parker of Parson Consulting will discuss the pressures on the finance function, including reliability of information, complexity and increasing demands from the business.
For further details – see page 15

IN THIS MONTH'S MAILING ...

Manager Update

Issue 24

Accounting and finance
The revolution in risk management

Marketing
Using 'mobile' and 'conventional' markets

Human resources management
The challenge of call centres

Strategy and organisation
Learning from experience

Pensions – the growing challenge for business

Has there ever been a time when more controversy surrounded pensions? There have been scandals in the past, but now the pensions industry faces challenges on many fronts. As the City digests the government's recent green paper on pensions, **David Bird** looks at the outlook for the pensions industry – and for business.

If the subject of pensions seems overwhelmingly baffling, and ever more complex, it is hardly surprising. Recently we have seen:

- a new accounting standard that has led many employers to question the role of pensions;
- an acceleration of the move towards defined contribution and away from defined benefit;
- pension schemes closing with members not getting the benefits they felt were promised to them;
- a major pensions saving institution becoming all but bankrupt;
- government policy in disarray and confusion; and
- a demographic crisis growing, as the average age of the population rises.

And it is against this background that finance professionals and their human resources colleagues are expected to make decisions that can balance the needs of the company and its employees. In an attempt to give the reader some signposts this article seeks to:

- explain where we have come from and why we are where we are now;
- revisit the reasons why employers run pension arrangements at all;
- identify what employees need; and
- provide some pointers towards developing a pensions strategy in the current environment.

Pensions – a brief history

Pension provision by UK companies for their employees has been described as the most important welfare success of the post-war years. Prompted largely by tax incentives, many, and particularly large, employers have squirreled away vast amounts of wealth into pension arrangements for the benefit of their employees in retirement.

High investment returns and relatively high inflation (reducing the real value of these pension promises) made those pension promises seem affordable. Pensions were part of a deal between the employer and the employee that rewarded long service and loyalty, with the funding of that promise being largely a matter of trust.

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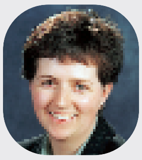

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THE FACULTY COMMITTEE

Pensions – *from page 1*

A number of factors have increased the cost of those pension promises, eg:

- minimum funding requirements for pension schemes;
- inflation-linked pensions;
- pensioners living a lot longer;
- accounting changes giving rise to volatility in the reported costs and liabilities of the pension arrangement; and
- a weak stock market offering low yields and poor returns.

To illustrate some of these factors consider the increase in the cost of buying a single life pension of £5,000 per annum for a male aged 65 in November in the years 1994, 1998 and 2002. The table (below) shows the cost with and without inflation linkage (which became mandatory for pensions earned after 6 April 1997).

So, a company-sponsored pension scheme has to find nearly 50% more to buy the same pension now than in November 1994 and more than 100% extra for the same pension indexed-linked, as now required by law.

The response of a lot of companies to this increase in costs has, until recently, been inaction brought on by the complacency born of a healthy pension surplus, positive investment returns and a misunderstanding about the risks that the increase in pension costs implies to the sponsoring employer. The large falls in the investment markets and a reappraisal of the accounting of pension costs and liabilities have brought the issue of pensions screaming onto the front page.

So, why do employers have pension arrangements for their employees?
The answer to that question is really very simple: to give a competitive advantage over other employers in the labour market. It follows that:

- the more competitive the labour market for particular skills the more likely it is that an employer will have a pension scheme;
- larger employers are more likely to have a scheme as they face more competition in the labour market;
- unionised workforces are more likely to have negotiated better pension provision than non-unionised ones; and
- smaller employers, in industries with employees who are not unionised, are least likely to offer a pension scheme.

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Pension schemes were an important part of the 'employment deal' for a long time. The majority of traditional pension schemes were established as defined benefit schemes (those that promise a specified level of pension) as they suited employers with large stable workforces. As the labour market has changed, with employees changing jobs more frequently, so has the 'employment deal'.

The new deal is more about individual performance and less about loyalty and long-service, more about attracting the right skills required now and less about offering a lifelong career. Such changes have led to a reappraisal of the place of pensions in the 'employment deal'. Increasingly, defined contribution plans have been seen as an attractive alternative.

So, what do employees need?
Answering this question is non-controversial – employees need to secure enough money to provide them with

Cost of pension of £5,000 pa	Level	Inflation-linked
November 1994	£42,015	£58,410
November 1998	£54,945	£72,045
November 2002	£66,050	£85,715

a retirement income to last the rest of their (and their spouse's) life. The question that is more difficult to answer is; as this must ultimately be the employee's responsibility, what is the role of the employer?

Traditionally the employer has taken on much of the onus for providing pensions for employees but the increases in cost and risk for the employer have meant an increasing shift in the burden onto employees.

Figure 1 (below, right) illustrates two particular things:

- there is more to pension design than the black and white of defined benefit versus defined contribution; and
- moving from defined benefit to defined contribution is about a transfer of risk from the employer to employees (a transfer that employees are not fully prepared to deal with).

> Companies need to take into account the 'deal' they want to strike

Many employers reviewing their pension arrangements are choosing to move to a defined contribution basis. Most starting pensions for the first time also choose defined contribution. The impact of this can be very harmful on the employees' prospects of reaching an appropriate level of pension benefit at retirement age.

The 2002 National Association of Pension Funds (NAPF) Survey has revealed that whilst the average employer contribution into a defined benefit scheme is 12.86% the average into defined contribution arrangements is less than half that at 6.05%.

A contribution of half as much will only buy a pension of half as much, all other things being equal. In addition there is a transfer of risk to the employee, typically with little help being given to educate the employees about the decisions that they face in order to secure an appropriate level of income in retirement.

What sort of pension should my company have?
There is no one right answer. It depends on what you are trying to achieve as an employer and how much involvement you want in the day-to-day management of that arrangement. Companies need to take into account the 'deal' that they want to strike with their employees. Do they want to reward performance now or provide deferred pay (which is what a pension scheme is)? They need to ask themselves:

- what the benchmark for employees is in their industry;
- what they are doing for new hires, and whether this is different from existing employees; and
- how long employees typically stay.

By answering these questions an employer can develop a reward strategy including an approach to pensions that meets the needs of the business and offers a 'deal' that is attractive to potential employees.

In practice, what we are seeing is that many employers are moving away from traditional defined benefit arrangements. The 2002 NAPF survey showed that 84 schemes have closed to new members, twice the number in 2001 and four times the number in 2000. It would be a mistake to assume that all of the replacement arrangements are defined contribution, they are not. A growing number have pension designs that share risk and cost more equitably with employees.

In the new environment employers are deciding how much they need to spend to get the 'deal' right based largely on the competitive pressures in the labour market in which they operate. When thinking about how to divide the pot between pay, bonus and benefits, employers need to assess what the competitive position is for them and what type of 'deal' they want to build (many now give employees choice about this through flexible benefits arrangements).

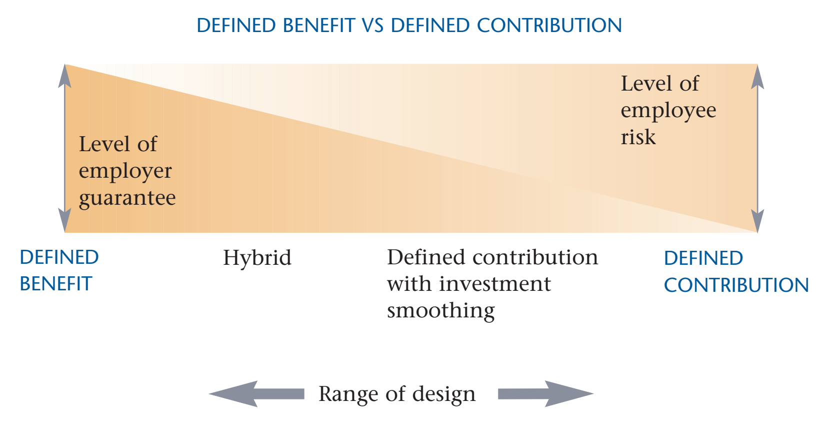
What does this mean for employees?
It means a high degree of uncertainty about what their retirement income will be. They are being asked to take responsibility for deciding:

- how much to contribute;
- how to invest;
- when they can afford to retire; and
- how to secure an income in retirement.

Employees are generally ill-equipped to make those decisions. It is likely that the role of the company in providing for employees' retirements will evolve from concern with funding pension arrangements to offering facilities for savings with education and advice on making the best use of those opportunities. **F&M**

**Although the government's consultative green paper, published late in 2002, 'Simplicity, security and choice: working and saving for retirement', contained some very important proposals for pensions, the issues for companies remain largely as described in this article.*

Figure 1 **The pensions issue**



Corporate governance – time to take stock

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Corporate governance was one of the hot topics during 2002 and will continue to be so in 2003. The failings of Enron et al prompted governments, regulators and others around the world to re-examine many aspects of corporate behaviour. **Jonathan Hunt** explains.

In many ways what the US has gone through in 2002 leaves us with a sense of déjà vu. The UK experienced corporate scandals in the late 1980s and early 1990s (Maxwell, BCCI etc) that created a reduced level of confidence in financial reporting and brought corporate governance to the forefront of public interest.

Up went the cry of 'something must be done.' Déjà vu? Yes, but we went about our corporate governance reform in a rather different manner, for a variety of reasons. *Finance & Management* has already referred (Issue 95) to the Sarbanes-Oxley Act in the US, and will return to the topic in a future issue. This article therefore concentrates on key matters for the UK, finishing with a look at developments in Europe.

How often have you heard the words Cadbury, Greenbury, Rutteman, Hampel, Turnbull and not really known what each is about, or what authority each currently has? And where does the Combined Code fit in?

To set the scene, in 1991 the Financial Reporting Council, the London Stock Exchange and the accountancy profession established the Committee on the Financial Aspects of Corporate Governance.

Better known as the Cadbury Committee, after its chairman, Sir Adrian Cadbury, the committee issued its ground breaking report in 1992 which included a Code of Best Practice with which the boards of all listed companies were recommended to comply.

The committee also encouraged boards of other organisations and non-listed companies to try to meet the requirements of the Code.

Cadbury, 1992 (now part of the Combined Code)

Although now superseded by the Combined Code, "the Cadbury report is an important document from both an historical perspective and as one of the leading explanations of what good corporate governance entails. It has proven highly influential, both in the UK and abroad, and continues to be referred to." So said the 'Comparative study of corporate governance codes relevant to the European Union and its member states' (January 2002).

Cadbury defined corporate governance as 'the system by which companies are directed and controlled'. There are other, wider definitions such as that adopted by the OECD, but Cadbury's definition is a good starting point. Cadbury was the first code to recommend a 'comply or explain' approach which essentially means comply with the Code or explain, giving reasons, why you haven't.

The headline recommendations in Cadbury were that:

- boards should retain full and effective control over the company and monitor executive-management;
- there should be a clearly accepted division of responsibilities at the head of a company, which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision. The report referred to splitting the roles of chairman and chief executive (something to which many in the US currently remain opposed);
- boards should include non-executive directors, the majority of which should be independent of management. There was reference to the work of the remuneration committee and the audit committee;
- boards must present a balanced and understandable assessment of the company's financial position. They should ensure that an objective and professional relationship is maintained with the auditors, and each should explain to shareholders their respective responsibilities; and
- boards should report on the effectiveness of the company's system of internal control, and that the business is a going concern (with supporting assumptions or qualifications as necessary).

Rutteman, 1994
(now superseded by Turnbull)
It was Cadbury's recommendation about reporting on the effectiveness of the corporate system of internal control (and that the auditors should report thereon) which needed additional guidance for both directors and for auditors before it could be implemented. This led to the establishment of the Rutteman Committee.

The Rutteman Committee produced a 67-page consultation document containing a detailed framework and accompanying guidance to help companies review detailed aspects of their internal financial controls.

Many respondents to the consultation document thought that *inter alia* it was too detailed and in 1994, the final eight page report was produced. It was essentially a principles-based approach to reporting on internal financial control.

Greenbury, 1995
(now part of the Combined Code)
Controversy over remuneration packages for executive directors led to the establishment of the Greenbury Committee to identify good practice in determining directors' remuneration. The report did not refer to any other aspect of corporate governance. Its recommendations referred to remuneration committees and more detailed/transparent reporting to shareholders.

Hampel, 1998
(now part of the Combined Code)
Cadbury had recommended that his code be reviewed by a successor body. The Hampel Committee was set up in 1995 and issued a final report in January 1998. The committee set out *inter alia* to review the Cadbury Code and its implementation to ensure that the original purpose was being achieved, proposing amendments and deletions as necessary; and to pursue any relevant matters arising from the Greenbury report.

The committee's basic premise was that the principles of corporate governance should be applied flexibly, with common sense and due regard to companies' individual circumstances, and that the annual report should explain the application of the principles.

One of the main changes Hampel made was to return the debate from internal financial control to internal control. Hampel accepted that it is difficult to distinguish 'financial' from 'other' controls. His committee's conclusions benefited from developments in companies' risk management practices, as it was becoming more accepted that it was important for directors and management to consider all aspects of risk and control.

Hampel also dropped the 'effectiveness' word from the Cadbury Code, so that 'directors should report on the company's system of internal control'.

He recognised that the word 'effectiveness' had proved difficult for both directors and auditors in the context of public reporting in that it can imply that controls can offer absolute assurance against misstatement or loss; in fact no system of control is proof against human error or deliberate override.

Hampel went on to refer to concern over exposure to legal liability if unintentional misstatement or loss of any kind is found to have occurred. This is an issue that is now very much to the fore again with the development in the US of the SEC's rulemaking process for Section 404 of the Sarbanes-Oxley Act.

Turnbull report, 1999
(current document)
The Turnbull Committee commenced work (under the auspices of the Institute) in November 1998. It produced a consultation document in April 1999 and a final report in September 1999. There were transitional arrangements for companies reporting with December 1999 year-ends, and full implementation commenced in the year 2000.

Little need be said here about the Turnbull report, it should be familiar to many readers. One point of note was that during the drafting we con-

The Combined Code, 1998 (current document)

The Hampel report, which, after some amendments, consolidated Cadbury and Greenbury, was then transformed into the Combined Code and in June 1998 the UK Listing Authority published a new Listing Rule together with the new Combined Code.

The Code is the UK's current primary corporate governance document. It is supplemented by the Turnbull report that amplifies the internal control principle and provisions set out in the Code.

The Code is appended to the London Stock Exchange's Listing Rules. Paragraph 12.43A of the Rules states that:

> "in the case of a company incorporated in the United Kingdom, the following additional items must be included in its annual report and accounts:
>
> - a narrative statement of how it has applied the principles in the Combined Code, providing explanation which enables its shareholders to evaluate how the principles have been applied; and
> - a statement as to whether or not it has complied throughout the accounting period with the code provisions set out in the Combined Code.
>
> A company that has not complied with the code provisions, or complied with only some of the code provisions or (in the case of provisions whose requirements are of a continuing nature) complied for only part of an accounting period, must specify the code provisions with which it has not complied, and (where relevant) for what part of the period such non-compliance continued, and give reasons for any non-compliance."

For listed companies there are 14 code principles and 45 code provisions. External auditors report on seven of the provisions.

As was the case post-Cadbury, further guidance was required on the internal control principal and provisions. This led to the formation of the Turnbull Committee.

sidered that, as well as being an exercise undertaken to meet regulatory requirements, there was a business benefit to help boards and senior management to improve their risk and control systems on a continuous basis. The guidance is intended to:

- reflect sound business practice whereby internal control is embedded in the business processes by which a company pursues its objectives;
- remain relevant over time in the continually evolving business environment; and
- enable each company to apply it in a manner which takes account of its particular circumstances.

For those who need a copy of the Turnbull report, it can be found at www.icaew.co.uk/internalcontrol.

Looking forward

At the time of writing, neither the Higgs report on the role and effectiveness of non-executive directors nor the Financial Reporting Council's (FRC's) review of the Combined Code's requirements on audit committees had been issued.* The Financial Services Authority (FSA) is also undertaking a review of the Listing Rules. The Institute's submission to the Higgs review is to be found at: www.icaew.co.uk/policy/index.cfm?AUB=TB2I_25434.

Within Europe, in early November 2002 the High Level Group of Company Law Experts, which included aspects of corporate governance within its remit, reported its recommendations to the European Commission. Its web reference is http://europa.eu.int/comm/internal_market/en/company/company/modern/index.htm.

The EC will now have the task of taking forward the group's recommendations and its conclusions on how to do this should be available in the first half of 2003. Many of the group's recommendations will be familiar to those in the UK who have to work to the Combined Code and the disclosure and other requirements of the Companies Act. The group, in line with the 'Comparative study of corporate governance codes' mentioned at the outset of this article, is not recommending a European corporate governance code, so (at least for the foreseeable future) UK listed companies will have to report under the Combined Code.

Further afield in the US, the Sarbanes-Oxley Act and the SEC's rulemaking thereon will have an impact on UK listed companies that are also SEC registrants. At the time of writing, the SEC is part way through its rulemaking process and the outcome of a number of clauses in the Act is far from certain. The Institute made a submission to the SEC on its internal control proposals and it will also be responding to other relevant proposals as they are issued by the SEC.

What is, however, certain is that the role of boards, and particularly their audit committees, is going to be a fundamental part of the future corporate governance framework on a worldwide basis.

Expectations of audit committee are high and rising and the time spent by committee members is likely to increase and they may need to be better trained. Chartered accountants are likely to be increasingly approached to sit on such committees, but they will need to ensure that they are up to date.

This year is likely to be another busy one from the corporate governance viewpoint. **F&M**

** This article was written before the Higgs and FRC reports were issued. A further article on these reports will appear in a future edition of F&M.*

Useful web sites

European Corporate Governance Institute – website of the ECGI which aims to be 'a focal point for information on corporate governance'. The site includes an impressive archive of library materials which includes a directory of downloadable codes and principles from across the world arranged by continent, including the UK. The directory also lists a selection of international comparative summaries.
www.ecgi.org

International Corporate Governance Network – founded in 1995 following the convergence of corporate governance bodies around the world. The site sets out the history and principles of the organisation, along with various statements of principles, including an amplification of the OECD Principles, and the ICGN's approach to the them.
www.icgn.org

Internal Control: A Practical Guide (KPMG) – described as a guide prepared to assist 'clients and others' in understanding the implications of the ICAEW's Turnbull report. The guide is available to view/download in PDF format (96 pages).
www.kpmg.co.uk/kpmg/uk/services/audit/finaudit/links/int_cont.cfm

Corporate Governance: the New Strategic Imperative – full text white paper from the Economist Intelligence Unit and sponsored by KPMG. The EIU surveyed senior executives across the world for their views on corporate governance and the paper identifies their concerns for corporate governance and transparency. Available to view/download in PDF format.
www.us.kpmg.com/microsite/Attachments/corp_govern_newstrat.pd

Encycogov – vast non-commercial encyclopedia on corporate governance, previously known as 'The Corporate Governance Encyclopedia'. The site includes resources on general topics, as well as specific issues relevant to professionals, such as ownership structures and incentive pay systems.
www.encycogov.com

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

Maximising IP value in outsourcing

The popularity of outsourcing seems indisputable, but it is not without potential risks. For example, how do you protect your intellectual property rights – particularly when outsourcing information systems? **Rachel Broquard** provides guidelines on how to protect IP values.

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Intellectual property (IP) issues arise to some extent in all outsourcing transactions, but are particularly important in relation to outsourcing of information systems where a variety of IP rights belong not only to the customer of the outsourcing supplier (ie your company), but also to a number of third parties. By taking a number of procedural steps a company can minimise the risks involved with the transfer of third party IP rights, maintain the value of existing customer-owned IP and maximise the value of deliverables from the outsourcing provider. These steps are as follows:

Step 1 – an IP audit

Prior to the outsourcing transaction, an audit of the relevant IP should be carried out. This allows you to:

- identify which IP needs to be licensed to the supplier chosen to carry out the outsourced services;
- determine whether the relevant IP is owned by the company itself or licensed from a third party; and
- decide upon the appropriate steps to be taken to transfer third party IP to the supplier at minimal cost, and put in place procedures to maintain ongoing protection of its company owned IP.

Hence the audit will involve compiling the following:

- a list of all systems and corresponding IP rights to be subject to the outsourcing;
- a list of registered IP;
- a list of any appropriate applications for IP registrations which need to be made prior to the outsourcing transaction; and
- a collation of copies of any IP licences or other instruments affecting the IP, such as a charge.

Bear in mind the audit should also be performed:

- as early as possible in the transaction, to allow sufficient time to obtain any relevant registrations and necessary consents; and
- by appropriately trained personnel (identification of IP requiring specialist skills and experience, particularly in relation to innovative technology and systems).

> Many software licences prohibit transfer

The information obtained during the audit will serve a secondary purpose, relating to any due diligence exercise the outsourcing supplier chooses to carry out on the company and the way things are currently undertaken there.

In such an exercise the supplier will request to see many documents, in particular those relating to IP. If these documents have already been organised and collated for the internal audit, you will save time and money.

Step 2 – third party IP

After this audit, the company should have a complete list of the relevant IP which is currently being licensed from third parties and which is to be outsourced to the supplier. The next step is to ensure that any risk in the outsourcing of these rights is managed effectively.

The company's lawyers can assist in advising on the terms of the relevant licences and identifying the steps to be taken to transfer the IP without breaching the terms of the licence.

Danger...

One danger is that many software licences contain express provisions prohibiting the transfer of the software from the named licensee, in this case the company, to third parties, even if the software will continue to be used for the company's own internal business purposes. Without obtaining the necessary consents to the transfer from the software provider, the company's outsourced services supplier may find itself having claims brought against it for infringement of the IP rights in the software, and may in turn bring an indemnity claim against the company. The software provider may also bring a direct claim against the company for breach of the original software licence if it did indeed prevent unauthorised transfers.

So, a preliminary approach should be made to the software provider third parties as far as possible in advance of the outsourcing transaction. This will ensure that sufficient time is available to obtain consent or to agree any amendments to the terms of the licence, or where necessary to negotiate the grant of a new licence.

Confidentiality undertakings?

The timing of any such approach must be balanced of course, against any confidentiality requirements in relation to the outsourcing transaction as a whole, particularly where delicate employment issues are involved or the transaction is potentially share price sensitive. It may therefore be appropriate to request that third party licensors enter into confidentiality undertakings at the time of the initial approach and that any negotiations with third parties are channelled through selected individuals within the organisation.

Step 3 – company-owned IP
A high priority should be to ensure that all company-owned IP is in order. This will include:

- reviewing all registrations to check they are valid and up to date;
- registering further IP where deemed necessary; and
- checking that the company owns all important IP (eg by checking its employment and development contracts to ensure necessary rights are transferred and waivers given).

The licence of company-owned IP will of course be subject to a number of restrictions. These need to be carefully drafted to ensure that the company:

- maintains maximum control over its IP (to minimise the risk of any detrimental effect of the service supplier's actions), but also;
- avoids interfering with the supplier's desire to operate the services efficiently;
- limits the licenses it grants to the term of the main outsourcing agreement and to the purpose of carrying out the outsourcing activities; and
- in the event of the use of IP by any of the supplier's sub-contractors, it maintains control over the grant of sub-licences.

Compliance on brands, trademarks and corporate social responsibility
Equally important is the maintenance of tight controls on trademarks and brands, and the supplier should be made fully aware of these and the importance placed by the company on protecting its brand image. A separate obligation of compliance with branding/trademark guidelines and/or restrictions and any other reasonable requests of the company should be put in place, and the supplier (and any of its sub-licensees) be required to inform the company immediately on becoming aware of any breach of its IP by a third party and to give co-operation in any action against perpetrators.

If the company has a corporate social responsibility (CSR) policy, it will be necessary to ensure that the supplier's business methods are compatible with this policy. It will be important to carry out due diligence on this area of the supplier's business particularly where the company's goodwill in its brand is linked to CSR.

Indeed, many organisations are increasingly concerned that their reputation can be damaged through transacting with suppliers whose business methods are not publicly perceived to be environmentally or socially sound. From this point of view it is important to include in the service agreement a provision requiring the supplier (and any sub-contractor or assignee) to comply with the company's CSR policy, as it may be amended from time to time.

> It may be possible to divide up the IP so each is able to exploit it

Step 4 – deliverables – who owns the new IP rights?
It is likely that the outsourced activities will generate new IP rights. These may range from potential patents in the systems to copyright in software, design or graphic work, to database rights in customer databases. A decision should be taken at the outset as to ownership of such rights, and express provision should be included for the assignment of such rights to the company.

The supplier on the other hand, may want to retain the IP which can then be provided to other customers, some of whom may be competitors of the company. The company may allow the supplier to retain the IP in return for a reduction in fees. The company may also want to explore with the supplier the possibility of an assignment of the IP to the company with a licence back to the supplier with royalty payments when sub-licensed to third parties.

Finally it may be possible to divide up the IP so that each is able to exploit the IP in different business areas. In any event, the company should consider whether it wishes to restrict the supplier's use of the IP so as not to benefit competitors.

If the company is to become the owner of the newly created IP, the supplier should be required to take all action necessary to ensure that the IP is effectively transferred to the company. The company will want an indemnity on assignment of such rights from the supplier to indemnify the company against any defects in title or breaches of third party rights in the creation or use of the newly created IP. A general indemnity for breach of third party IP rights in the provision of the outsourced services would also be required. On assignment, it will also be necessary to licence the IP back to the supplier (and any sub-contractors) to enable it to continue to use the IP to provide the services. The assignment and licence back structure must continue for the period during which IP will be created.

Step 5 – termination
Finally the agreement should provide for termination and damage limitation measures to ensure as smooth an exit as possible. For example, the agreement should give the company permission to enter the supplier's premises to:

- retrieve all IP and related documents;
- ensure the company has equivalent rights with respect to any sub-contractors; and
- provide for assignment of IP post-termination if required – a power of attorney could be granted in favour of the company to enable it to assign any new IP should the supplier fail to do so.

Conclusion
The raft of measures outlined above should ensure that the company maintains and maximises the value of its IP in an outsourcing transaction while minimising the risk of detriment that may be caused by its suppliers. They also help identify areas where revenue can be generated or discounts obtained. However, the process necessarily starts with ensuring that the company itself values and affords sufficient protection to its IP. **F&M**

Reality check – how strategy creates wealth

Strategy consultants have had a bad press lately for their apparent contribution to the over-egging of the 'new economy' pudding. However, as **Bob Gorzynski** explains in this summary of his recent lecture 'Reality check – the key role of strategy in creating wealth', there is nothing like a recession for helping businesses 'get real' with future plans and ideas.

Bob Gorzynski is the lead lecturer in Bristol University's recently launched London-based MSc in Strategic Management for Professionals. For more details, tel: 011795 45653; e-mail: joy.eldieb@bristol.ac.uk www.bristol.ac.uk/mrc

'Every intelligent person in the world knew that disaster was impending but knew no way to avoid it.' (H G Wells, quoted in the entrance to Flanders Fields War Museum, Leper, Belgium.)

It is a sign of the times that we are not reading business books as we used to. In the US, sales slipped from 5.8% of total books in 1999 to 4.2% in 2001. And in this new world, both strategy consultants and accountants have found themselves being called to account for their part in over-egging the 'new economy'.

The *Economist* has called 2002 an 'annus horribilis' for strategy consultants. It claims that they escape the most serious charges of 'abetting the bull-market misdeeds of America's former corporate darlings' only because their responsibility is limited to their 'wonky ideas and advice rather than responsibility for execution'. This hardly seems an appropriate time to lay claim to strategy being at the root of wealth creation! Rather, newspaper headlines scream at us of the destruction of wealth on a grand scale, largely as a result of seriously 'flawed' strategies. And there may yet be worse to come.

Those of us who would like to believe that the global economy will now climb gently out of recession are probably in for a very rude shock in 2003. However, recessions play a critical role because they force us to return to fundamentals and 'get real' about business ideas. They ground visionary thinking in the nuts and bolts of day-to-day reality. If this sounds complex and paradoxical it is. It is the nature of the 'reality check' and it is the most important aspect of strategy. Moreover, it is an area where finance professionals play an invaluable role.

The paradoxical nature of strategy

It is widely held that there are two key strategic questions; 'where do we want to be?' and 'how do we get there?'. In fact, there are three. And the other, most important, strategic question is 'where are we now?'. Put together (see Figure 1, on page 10), these three questions form the basis of the strategic journey, which involves matching internal capabilities (or 'core competences') with external market needs, ie 'positioning', in strategic terminology.

> Creative tension cannot be conjured from vision alone

A strong sense of reality

It is sadly a very common mistake for executives to commence the strategic process by asking where the organisation 'should' be in the future, without ensuring that there is a realistic overview of where it actually is today.

Grounded strategies are rooted in a strong sense of reality without any implication that they are bounded by that knowledge of what 'is' today. It is the creative tension between vision and awareness (the quality that underpins an accurate assessment of reality) that provides the momentum for radical change and sustainable wealth creation. Peter Senge, director of the Centre for Organisational Learning at MIT's Sloan School of Management, captures the nature of this symbiotic relationship as follows:

"Many who are otherwise qualified to lead fail to do so because they try to substitute analysis for vision. They believe that, if only people understood current reality, they would surely feel the motivation to change. They are disappointed to discover that people 'resist' the personal and organisational changes that must be made to alter reality. What they never grasp is that the natural energy for changing reality comes from holding a picture of what might be that is more important to people than what is." (Peter Senge, in 'The Fifth Discipline Field book: strategies and tools for building the learning organisation'.)

But creative tension cannot be conjured from vision alone; it demands an accurate picture of current reality as well. Vision without an understanding of reality will more likely foster cynicism than creativity. The principle of creative tension teaches that an accurate picture of current reality is just as important as a compelling picture of a desired future.

The role of financial professionals

'Bean-counter' is the subtle form of put-down that marketing and sales professionals often use against their financial professional peers. Most often used in the context of 'here are our plans, now let the bean-counters give them the once over', this is not intended as an expression of parity.

It implies that the really difficult work is envisioning the future, while the only thing required from the financial person is to make sure that the numbers add up.

Yet nothing could be further from the truth. Underlying all good strategies are insights into the marketplace, which have been translated into a profitable business model. As many 'new economy' entrepreneurs found to their cost, unique insights on their own do not make profitable long-term sustainable businesses. They destroy wealth – big time.

Business models are, at heart, stories, which capture the essence of how a business proposition works – who is the customer, what needs are we meeting and what is the underlying economic logic that allows us to deliver value to customers at an appropriate cost? A successful business model depends on two tests:

- *the narrative test* – the story must make sense (for example, the assumptions about customer behaviour must be robust); and
- *the numbers test* – the profit and loss must add up.

Financial professionals play a key role in creating, shaping and reviewing strategies from both these perspectives. It is as, or more, important to challenge the core assumptions of a proposed strategy as it is to make sure that it makes sense in economic and financial terms. In the very early days of broadband distribution in the US an assumption was that large population centres would yield the highest returns when wired up.

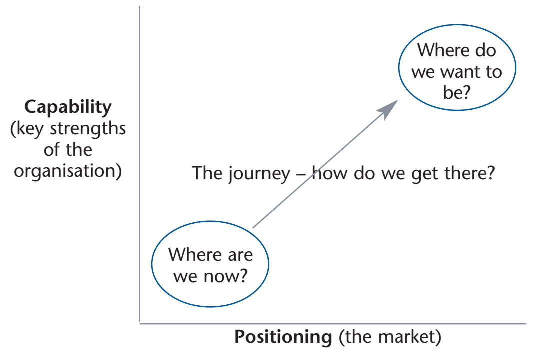
This has turned out to be a grossly simplistic and misleading assumption as metropolitan consumers already have an extensive choice of media content through their existing cable connections. Not surprisingly, adoption rates have failed miserably to meet early expectations. A good 'reality check' in this case would have been to look closely at the experience of City states such as Hong Kong and Singapore in terms of broad media adoption. (Further discussion can be found in 'Why business models matter' by Joan Magretta, *Harvard Business Review*, May 2002.)

What goes wrong in practice?

I am fortunate enough to know several people who can genuinely be called visionary. They share certain qualities; they are driven, passionate, disorganised, impulsive and intellectually demanding. They are very good at synthesis (creating new insights by bringing together knowledge from seemingly unconnected sources) and inspiring.

However, I would think twice before investing in a business venture with them. Unless, that is, they have the foresight to include a partner with complementary skill sets, someone who can challenge their core assumptions, question their economic model and have the practical planning skills to manage the profitable implementation of their ideas.

Figure 1 **The strategic journey**



> To be passionate about the reality check takes guts

We are all different and there are, of course, highly creative financial professionals. Indeed, many of us are actively engaged in the strategic process of our organisations, helping to contribute to a clear sense of direction and managing the tensions between a future orientation and a genuine appraisal of our current capabilities.

However, more often than not, the key role for financial professionals is that of devil's advocate, to use their knowledge, skills and intellectual abilities to test thoroughly the foundations of an organisation's strategic vision. In reality, this is a far more difficult and challenging role than it appears to be because it requires not only intellectual rigour but also emotional fortitude.

Emotional maturity – finance's trump card

I suspect that I am not alone in reading business books and wondering whether the authors have actually worked in a business. The intellectual skills required to play the role of devil's advocate are not complicated, although there is a need to maintain broad enough horizons to be able to see the 'big picture' and maintain an external perspective when appropriate (easier said than done). But it is not at this level where a financial professional really makes a difference, no matter what the best selling business books may say. In practice, it is in the level of emotional maturity that the real difference is made.

To be passionate about the value of the reality check takes guts. It will mean looking at the 'shadow side' of organisational behaviour – ie the covert, non-explicit way of doing things which do not get discussed and managed in decision-making forums – and having the courage to say that all the brand research, customer surveys and focus group research just may be wrong.

It may mean 'taking on' your business partner, chief executive officer or the entire executive team. It may even be highly unwise in career terms; few professionals are rewarded if they are regarded as obstacles to progress. This is real life after all. But is it important? You bet it is. Take a cursory glance at today's financial pages if you are in any doubt!

Strategy and wealth creation

In the difficult times ahead organisations will increasingly focus on the fundamentals. Sustained wealth creation depends not only on technological innovation, customer insight and the drive to succeed; it requires robust and solid foundations; in other words, to build one's house on rock rather than sand. This is the essence of the reality check and financial professionals have a key part to play. **F&M**

Extracting value from performance data

*Dr Mike Bourne is lecturer and director of programmes at the Centre for Business Performance, Cranfield School of Management.**
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Choosing, designing and implementing a performance measurement system is one thing – but what about extracting maximum benefit from that system? **Mike Bourne** describes a seven-step performance planning value chain which deals with this aspect of performance.

It is 10 years since Kaplan & Norton published their first article in *Harvard Business Review* on the balanced scorecard. Since then the scorecard has become widely used. According to documented research 60% of the US Fortune 500 companies have some experience of it, and British companies are not far behind with nearly 40% of the FTSE100 adopting the scorecard.

To date, much of the work on performance measurement has featured the frameworks companies should use and how they should design and implement a balanced performance measurement system. There has been much less focus on 'how do we extract value from all this performance measurement data?'

How do we create 'management insight'?

Balanced scorecards help structure our thinking about business performance, but how do we create real 'management insight' to enable us to move businesses forward effectively? At the Centre for Business Performance, this is a question which has become a central issue for us and the companies involved in our Best Practice Round Table.

This was brought to a head last year when the centre was working with DHL in the UK. DHL had implemented the 'performance prism' (a multiple stakeholder scorecard) but it wanted the new performance measurement system to deliver greater value to the UK board than had been achieved in the past. My colleague, Yasar Jarrar worked with the company to develop an infrastructure that supported the board's need for information and answered the key business questions raised by the prism's framework. This involved creating a team of analysts who collated and presented the performance measurement information to the quarterly board meetings.

> Having a question gives focus to measurement

One of the problems he faced was creating a framework for processing the performance measurement results so that they were presented in a format that helped the board in its decision making, whilst giving it confidence in the information presented. The result of this work and work with other companies led the Centre for Business Performance to develop the performance planning value chain.

The performance planning value chain

The performance planning value chain is a simple framework that outlines the steps you need to take in extracting value from data (see Figure 1 on page 12).

The value chain comprises seven steps as follows.

1 Developing a hypothesis

The value chain prescribes that you start the process with a question to be answered or a hypothesis to be tested. This might be, for example, 'how do our customers perceive our current level of performance?' or 'we believe our new customer service initiative will increase customer satisfaction, is this actually the case?' Having a question to be answered gives focus to performance measurement and is an important first step in extracting value from data.

2 Gathering data

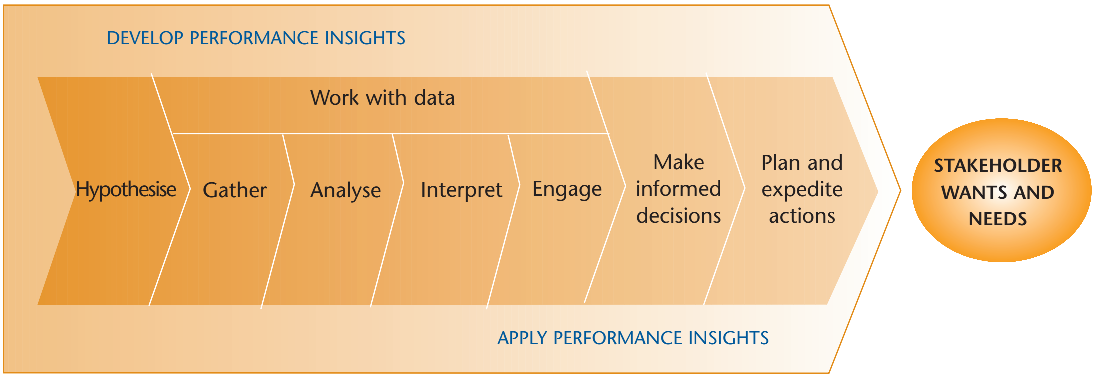
The second step is to gather the right data. This may involve extracting information from the existing performance measures or data mining for the exact information required. It may also involve surveying customers, consumers or employees. Selecting who you survey, the sample size and the questions asked are all important aspects of gathering data.

3 Analysing data

Having gathered the right data, it needs to be analysed. This may mean statistical analysis to look for trends and categorisations or looking for information on how widespread certain phenomena are. But this may also mean searching for root causes of problems, analysing qualitative data gathered through sales reports and other documents in the organisation or through focus groups consisting of knowledgeable outsiders. Whatever the context, some analysis of the data needs to be carried out. Far too often, organisations act on management intuition or anecdotes without a true analysis of the underlying data.

Figure 1

The performance planning value chain
(developed by The Centre for Business Performance)



4 Interpreting data
Analysing the data is not enough, it needs to be interpreted. By this we mean putting the data in context to give the information some meaning. For example, if we conduct a customer satisfaction survey and get a result of '4' (customers satisfied), what does that mean? There are obvious comparisons we can make to give such a result meaning – how does this compare with the last survey, better or worse? How does this compare with our competitors? How does this compare with the rest of the industry or other industries? All this contextual information gives meaning to the result. Far too often we give a number as the result of performance measurement which without context has no meaning at all.

5 Engaging the decision makers
Having interpreted the data, it is then important to communicate, especially to those who need to take action. This may involve presenting the data graphically in a way that grabs people's attention. It may involve creating a story that resonates with people in the business and sticks in their minds. Jan Timmer, when he was CEO of Philips, went as far as issuing a hypothetical press release to his top team announcing the bankruptcy of the corporation to get their full attention. This may seem a drastic move, but too often we fail to get our message across.

6 Making the decision
When all the work with the data has been completed often the decision is obvious to all. Lord Stokes, one time chairman of British Leyland, once said that by the time a problem reached him the difference between the options was so fine that his decision would make little difference to the business outcome. But we shouldn't just be tossing a coin. The decision should fit into the company's values and culture, be practical and support other strategic choices. It is in this context that pure judgement is required and senior executives earn their money.

> It is a reminder of the stages to go through

7 Taking action
Despite all the activity taken so far, there is no value unless action is taken. The problem with planning action is that it is very easy to produce a list of all the things we should do. The trouble is usually that they don't get done. The trick here is to prioritise – pick the few most important actions that should be taken and make sure they happen. A good example is Hewlett Packard's Hoshin performance improvement process. As a corporation, it has three breakthrough strategies, last year's which it monitors to ensure the benefits are not lost, this year's which is the main focus of activity and next year's. In this way, it deliberately limits the activity and concentrates on a few issues. Very few organisations are that focused.

Finally, all this activity should add value to the organisation by satisfying the wants and needs of the various stakeholders This is the ultimate goal but far too often we don't check whether the actions we take actually do this. Which brings us back again to the importance of having a hypothesis to test.

Using the framework
In practice, we don't simply apply the performance planning value chain in the linear manner described above. Often we have a question, gather some data and then reformulate the question. This happens at all the stages of the value chain and there is a constant cycling round among the different stages. But this is not the point.

The objective of the value chain is to highlight all the different stages that need to be taken when extracting value from data. It is a useful checklist and reminder of all the stages we need to go through if we are to have confidence in what the data is telling us. In DHL's case, it provided the analysts with a useful structure for analysing the information they were presenting to the board. It also gave the board confidence in the information being presented.

Besides being a useful framework for DHL, the performance planning value chain is being used as the basis for other research into how performance measurement practices influence business performance. **F&M**

** Cranfield School of Management is running a programme on extracting value from performance data on 17-19 March. Tel: 01234 751122*

MARKETING

How effective is 'effectiveness'?

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

Marketing communications play a more subtle part in business success than advertisers would have us believe, as **Alan Mitchell** explains in his latest Update column.

According to a prize-winning paper at the recent Effectiveness Awards of the Institute of Practitioners in Advertising, Sainsbury's Jamie Oliver advertising campaign "has delivered £1.12 billion in incremental revenue – making it 65% more effective in generating sales than any previous Sainsbury's advertising modelled – and delivered a substantial return on investment of … £27.25 for every advertising £ spent."

Do you believe it? The answer is important, not only because the IPA awards are aimed at people like you, but because your response will determine your entire approach to marketing communications – and related budgets. Broadly speaking, most people fall into one of two camps when it comes to marketing communications – those who embrace a 'strong' theory of communication and those who accept a 'weak' one.

The 'strong' theory

The strong theory goes something like this. Marketers use their communications to insert messages in consumers' heads – messages which, in turn, influence consumers to do the things we want them to do such as 'give preference to our brand' or 'be willing to pay more'.

Under the strong theory, if a business's base performance is N, then with the addition of effective advertising it will rise to N + x, where x can be very large: apparently £1.12 billion in the case of Sainsbury. It is vital, therefore, for firms to understand the secrets of effective messaging (for which, enter advertising agencies, brand consultancies and so on). Because if you aren't prepared to invest enough time, money and effort in getting the right message, creativity, execution, budgets and media, you'll never pluck the rewards of N + x.

The trouble with this strong theory is that there is virtually zero empirical evidence backing it – as independent researchers such as South Bank University's Professor Andrew Ehrenberg and his 'Justifying our advertising budgets' project demonstrate.

> With a gentle nudge, we are more likely to buy

The 'weak' theory

The alternative 'weak' theory is much more subtle. It assumes that consumers routinely ignore and even resist advertisers' blandishments, and that advertising works at a completely different level. Advertising makes brands famous – when we do think of purchasing within a particular category the advertised brand naturally pops into our head. And the mere fact that the brand has invested in advertising tells us that the supplier is putting his reputation on the line – which reduces our risk.

With this gentle nudge of a reminder – plus that added bit of reassurance – we are more disposed to try the advertised product, and to repeat the purchase if it meets our expectations.

With such a weak theory, advertising can never be a magic bullet of rocketing sales growth and super-fat margins. It's just a necessary part of the process of bringing a product or service to market – rather akin to baking a pie once you have made it. Advertising or 'branding' is not the secret of N + x. Rather, (assuming you have made a decent pie in the first place) poor communication will simply result in N - x performance. You have to bake the pie at the right temperature for the right length of time. Otherwise, its full potential won't be realised.

Thus for example, a closer reading of the IPA award paper suggests that Sainsbury's advertising worked within the context of "a total business reinvigoration" spanning store refurbishments, supply chain modernisation, overhauled stock control and innovation. The campaign's 'major role' was to help "close the floodgates of shopper exodus". Behind the startling headlines, in other words, we see the weak theory at work.

Historical disappointment

Yet time and again, the strong theory seems to prevail: when agencies and marketers argue for budgets; when the media talk about advertising and its effects; and when chief executives look to an advertising campaign to boost sales and margins.

Back in the middle ages, the alchemists had their own strong theory – a quest to turn lead into gold; or £1 into £27.25. Every prince employed an alchemist at his court. Even sceptical ones feared a rival might stumble on the elusive secret. But they were routinely disappointed. Alchemy became an expensive waste of time. So is the quest for the secret of marketing 'effectiveness', as per the strong theory of N + x. **F&M**

FINANCIAL REPORTING

Keeping the markets informed

Profits warnings and other cautious company statements nowadays seem an all-too-regular occurrence. But they are a necessary evil for quoted companies, in keeping all shareholders fairly informed. In his latest Update column, **David Chopping** provides a quick crash course in just what a company is required to tell the markets, and when.

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

No shareholder is ever happy to find out that a company has issued a profits warning. Unfortunately, quite a few companies have had to do just that over the last year. On the plus side, at least getting advance notice is better than only finding out that there is a problem when accounts are issued.

Profits warnings are just one of the notifications that quoted companies, whether fully listed or on the Alternative Investment Market (AIM) may be required to provide. Notification means making information public via a formal mechanism. The underlying aim of the notification rules is to ensure that all shareholders have access, at least in theory, to the same information at the same time, so that none is put at a disadvantage. The general rules are set out in the Listing Rules and the AIM rules. Companies are required to notify whenever there is a change in:

- their sphere of activity;
- their financial condition;
- the performance of their business; or
- their expectations as to future performance.

In each case, notification is only required where the disclosure of this information is likely to lead to a substantial movement in the price of the company's quoted securities.

Profits warnings obviously fall under this general disclosure requirement. And it should be remembered – though recently it has been easy to forget – that companies are also required to provide notification where their performance or position is likely to be substantially better than the market is currently expecting.

Companies are not normally required to provide any notification of matters that are currently in progress, or of negotiations with third parties, however central they may be to the company's business. They are allowed to provide this information to specified parties, such as professional advisers, so long as those parties are aware that they must not deal in the company's securities until the information becomes public.

However the exception to this rule is where the company has reason to believe that the information has already leaked out, or is likely to do so. In this case, the company must make a notification. This must, at least, state that the company is expecting to release information in the near future which may affect the price of its securities.

> All shareholders should, in theory, have information at the same time

In addition to the general principles of disclosure, there are various specific notification requirements. Some of the major ones are:

- substantial transactions, with specific rules on reverse takeovers;
- transactions with related parties; and
- directors' share transactions.

Substantial transactions

When determining if a transaction is substantial, the Listing Rules apply various tests by reference to assets, profits, turnover, market capitalisation and gross capital. Notification is required if any of the percentages involved in these categories is between 5% and 25%, with a circular required if the percentage is above 25%. The AIM rules are slightly simpler and require notification if any of the percentages exceeds 10%.

In neither case is notification required for revenue transactions in the ordinary course of business or the raising of finance which does not involve the acquisition or disposal of fixed assets. (Of course, it is possible that a revenue transaction in the ordinary course of business may be so large that it has a material effect on the performance or position of the business. In this case, it may still require disclosure under the general rules above.)

Related party transactions

Related party transactions, including transactions with directors, require notification at much lower levels, usually 5%. In the case of listed companies, the UK Listing Authority has to be informed of all transactions above 0.25% but below 5%, although they need not be notified.

Directors' share transactions

Directors' transactions in shares also need to be notified. All companies, even private ones, have to be told of directors' transactions in their shares. Listed and AIM companies are required to pass this information on. This information is studied avidly by some, who believe that directors' share transactions are a good leading indicator of a company's performance.

All notifications have to be given without delay. In practice, there will always be some delay between information becoming available to the board and when this information is passed on. But this period should be kept to a minimum. **F&M**

FORTHCOMING FACULTY EVENTS

To attend any Faculty event, please fill out the form which adjoins this page, remove it by tearing along the perforation, and mail it or fax it to the services manager at the Faculty's address given on the bottom of the form. If you have any queries relating to these or other events, please contact the services manager on 020 7920 8486.

19 February EVENING LECTURE (Chartered Accountants' Hall, London)	*'FINANCE OF THE FUTURE' – SCOTT PARKER, PARSON CONSULTING* Scott Parker, managing director of Parson Consulting, will discuss the pressures on the finance function, including reliability of information, speed, efficiency, complexity and increasing demands from the business. Registration is at 5.45pm; the lecture is at 6.00pm; the wine, buffet and networking start at 7.00pm.
27 February EVENING LECTURE (Chartered Accountants' Hall, London)	*'TRANSACTION MANAGEMENT' – JAMES HADDOCK* Project management alone won't get you a good deal, but sound processes can prevent you getting a bad deal. James Haddock, a transaction management expert, explores what finance directors need to consider before and during the transaction process to minimise the risk of failure. Registration is at 5.45pm; the lecture is at 6.00pm; the wine, buffet and networking start at 7.00pm.
27 March EVENING LECTURE (Chartered Accountants' Hall, London)	*'THE CHANGING ATTITUDE TOWARDS RISK MANAGEMENT' – RICHARD SHARMAN, KPMG* Richard Sharman, head of risk management at KPMG, explores ways to assess the real value delivered by your risk management framework and the return on your investment in the risk management process. Registration is at 5.45pm; the lecture is at 6.00pm; the wine, buffet and networking start at 7.00pm.
27 March EVENING LECTURE (Hibernian FC, Easter Road Edinburgh)	*'FINANCIAL REPORTING AND STANDARD SETTING' – SIR DAVID TWEEDIE, IASB* Sir David Tweedie, chairman of the International Accounting Standards Board (IASB) will outline his views on standards. This event has been organised by the members' services directorate of the Institute of Chartered Accountants in Scotland.To attend, e-mail Fiona Ormiston (IMS Administrator) – fiona.ormiston@icaew.co.uk – to pre-register an interest. 5.30pm for 6.30pm.
28 April EVENING LECTURE (Golden Tulip Hotel, Trafford Park, Manchester)	*'THE PROCESS OF IMPLEMENTING IAS' – NICK SCOTT, MANCHESTER METROPOLITAN UNIVERSITY* Nick Scott, a Chartered Accountant and a senior lecturer at Manchester Metropolitan University, examines the processes that companies need for reporting of international accounting standards (IAS). Registration is at 5.45pm; the lecture is at 6.00pm; buffet and networking start at 7.00pm.

RECORDINGS OF FACULTY LECTURES IN 2002

The following lectures and conferences held by the Faculty in 2002 are available, in both **audio** and **video** format.

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

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

18 FEB	VALUEREPORTING – A REVOLUTION? **David Phillips** of PricewaterhouseCoopers explains this new technique including how to manage for value and the benefits of greater transparency.
15 APR	STRATEGIC ENTERPRISE MANAGEMENT **Martin Fahy** of the National University of Ireland, Galway, discusses strategic management accounting decisions aimed at increasing shareholder value.
28 MAY	PAY FOR PERFORMANCE – DIRECTORS' REMUNERATION **Ruth Bender** of Cranfield School of Management discusses the structure of directors' remuneration in the context of creating value for shareholders.
18 SEP	HUMAN CAPITAL – MEASURING PEOPLE AS ASSETS **Andrew Mayo**, a consultant on international human resource management, discusses how to balance people's cost with a quantitative measure of their value.
8 OCT	ENTERPRISE PLANNING (ERP) SYSTEMS – DO THEY MEASURE UP? **Dennis Keeling** of BASDA, the international software standards body, explores the pros and cons of these systems and looks at software industry trends.

Do you have a 'world class finance function'?

After the accounting-led business failures at Enron and WorldCom, a straw poll of large companies' views on the key qualities of a 'world class finance function' produced interesting results, as **Gerry Cryer** reports.

In late 2002 Cryer Strategic Partnerships asked 16 large companies what, in their view, makes a world class finance function. Against the background of the accounting-based disasters of Enron and WorldCom, the purpose was to discover whether larger companies were concerned about the role their finance functions were fulfilling. Did they believe that the function's role was still to be creative and positive in driving the business forward?

The participants were presented with 14 statements (see box, right)which could describe a finance function's purpose, and asked which they considered the most important for world class status. They chose:

- providing a relevant, accurate and timely source of management information;
- being highly supportive and involved in the core of all the business decisions; and
- managing and delivering all financial regulatory requirements (eg external audits) on time.

Reality – 'being professional and a safe pair of hands'

Choosing from the same set of 14 qualities, the companies then nominated the greatest strengths of their own functions. The results showed that in practice, the ideal of 'providing a relevant, accurate and timely source of management information' lost out to 'being professional and a safe pair of hands'. (The other two leading qualities remained the same.)

Of those taking part in this straw poll most were from the finance function, although some were from IT and other disciplines. The companies' average number of employees was 9,500.

Conclusion

To be seen as a safe pair of hands is important in today's climate. However, there seemed to be a feeling that this was just a 'phase', and would not be such an overriding investment priority in future.

More worryingly, the fact that providing relevant, accurate and timely management information was not ranked as one of the current strengths of these companies' finance functions suggests that recent investment towards that end has not been – or is not perceived to have been – entirely successful. **F&M**

The 14 possible qualities of the world class finance function

1 Highly supportive and involved at the core of all business decisions.
2 Professional and a 'safe pair of hands'.
3 Generates and sponsors business initiatives.
4 Provides readily accessible support and help to the business responding to queries in a timely and careful manner.
5 Has skills and competences (outside its core activity), which relate to customer and operations needs.
6 Acts as an independent source of review, information and expertise.
7 Is a driver of competitive advantage and quality improvement.
8 Is a driver of increased output and cost reduction.
9 Is a driver of improved customer support.
10 Fully understands and supports the business drivers.
11 Provides a relevant, accurate and timely source of management information.
12 Manages and delivers all financial regulatory requirements (eg external audit compliance) on time.
13 Is the custodian of internal governance (eg internal audit, risk management and internal controls).
14 Is managed efficiently, cost effectively.

Gerry Cryer is the founder of Cryer Strategic Partnerships, which took the straw poll on a world class finance function.
E-mail: admin@cryer.org

IN FUTURE ISSUES...

Finance & Management
- The implications of Sarbanes-Oxley
- The company law review
- Managing your PR relationship
- Value based management in practice
- XBRL – is the revolution happening?

IN MARCH'S MAILING...

Good Practice Guideline, Issue 41
Implementing international accounting standards
The introduction of IAS regulations in Europe from 2005 represents a major change in financial reporting and requires detailed planning for the change now. This GPG looks at the processes that companies need to consider.

Finance & Management

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