Manager Update

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Manager Update

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Manager Update helps the general manager keep abreast of the latest articles in specialist management journals. The most useful ideas in the fields of strategy and organisation, marketing, accounting and finance, and human resources management are carefully selected from a wide range of publications with the busy general manager in mind.

Experts in each field explain and discuss the relevance, practicality and usefulness of the key new concepts and ideas, thus enabling the senior executive to keep really up-to-date.

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Manager Update is compiled and edited by Professor Keith MacMillan, director of the Centre for Organisational Reputation and Relationships at Henley Management College.

Comments and suggestions should be addressed to Chris Jackson BA FCA, Head of Faculty, telephone 020 7920 8486, e-mail chris.jackson@icaew.co.uk, or write to the Faculty at:

The Faculty of Finance and Management,
The Institute of Chartered Accountants
in England and Wales,
Chartered Accountants' Hall,
PO Box 433,
Moorgate Place,
London EC2P 2BJ

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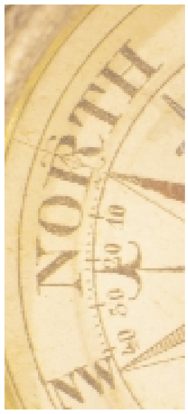

Could analysts have predicted the Enron debacle – or the more recent WorldCom events? With the benefit of hindsight, perhaps. In both cases, analysts following the companies were mesmerised by growth potential based on flimsy foundations – and some basic issues were overlooked. But what to do now? How should corporate America and its financial professionals clean up their acts? **Roger Mills** examines the Enron story – and draws some universal conclusions.

The Enron debacle – followed recently by the WorldCom affair – raises important questions about the business world, not least of which is now 'whom can you believe?'[1] According to *Business Week*, no less than 400 companies have re-stated their earnings in the past three years and accusing fingers have increasingly pointed at perceived lax accounting standards. In addition, some say, the greater use of off-balance sheet financing and other 'creative' accounting methods means only a forensic accountant can now make sense of corporate America's books!

Could analysts have predicted Enron?

In principle, a skilled reader of company accounts should be able to spot creative accounting practices. In fact, Christopher Higson, an associate professor of accountancy at the London Business School, suggests that a conscientious analyst, using only publicly available material, could also have anticipated Enron's fall[2, 3]. One would expect, he argues, rigorous financial analysis to proceed from the proposition that a company can only make its investors richer if it can grow and sustain a return on capital that is greater than the cost of that capital. To sustain a superior return, he says, a company needs some source of competitive advantage like, for example, a strong brand, valuable intellectual property rights, unique competences or a monopoly position.

Yet, even though Enron's revenues were increasing, he says, it was apparent that the company's return on capital was declining and that it was barely able to cover its cost of capital by 1999 and 2000. Between 1996 and 2000 Enron reported remarkable growth in revenues, including a spectacular 150% increase in 2000 alone. Earnings growth, however, was less impressive and before exceptional items averaged 13% a year between 1996 and 2000, compared with 19% from 1992 to 1996. Whereas in earlier years Enron had achieved a return on equity capital of about 17%, this had fallen to 10.8% by 1999 and to 9.5% by 2000, when Higson suggests the cost of equity capital was perhaps 9% to 10%.

Some 400 companies have re-stated their earnings in the past three years

A high stock price and poor profitability are not necessarily incompatible if future prospects are good. According to Higson, however, justifying Enron's 2000 stock price would have required it to sustain around a 10% rate of growth in revenues over a long horizon, but at much higher margins than it was achieving. For analysts recommending Enron, this would require a powerful 'transformational' story, ie the company, in their eyes, would have to create durable competitive advantages that would support much higher returns while arguing the presently depressed margins were caused by short-term investments in information technology and other intangibles.

But, as Higson points out, the run-up in the Enron stock price took place at much the same time as the internet boom. And, as with many of the new dotcoms, analysts seemed more pre-occupied by the growth potential of new markets than with return on capital or how a company would actually make revenue from these new markets.

Analysts were more preoccupied with markets than corporate growth potential

New rules for analysts

In the aftermath of Enron's bankruptcy, therefore, securities regulators have introduced new rules for US firms aimed at eliminating the conflicts of interest that supposedly encouraged research analysts to put their employers' interests ahead of their customers when recommending stocks[4]. While Enron was heading for insolvency, and even after bankruptcy filing, many large Wall Street investment firms and banks continued to recommend the company's shares to the public.

Now research departments will no longer be able to promise favourable reports

Now, research departments will, in theory, no longer be able to promise favourable reports to companies whose securities they are selling to investors. Nor will analysts be able to issue research reports on new companies until 40 days (presently 25 days) after the public offering.

Under the new rules, in future:

- a brokerage firm's compliance department must ensure the firms research and investment-banking group activities are kept separate. This is intended to prevent bankers from enlisting analysts to write positive reports on companies whose securities the firm is selling to the public;
- research reports will have to disclose when an analyst has received compensation from investment banking revenue generated at the firm;
- analysts will not be banned from owning shares in the companies they follow, but there will be limits on trading. This will include a ban on analysts trading against their recommendations, and there will be periods surrounding a rating change when analysts cannot trade for themselves. If an analysts firm owns 1% or more of a company's shares, that holding must be prominently disclosed in a report; and
- firms must provide investors with the range of the recommendations they have on stocks at any given time. For example, if the firm follows 100 stocks, it must disclose to clients how many it currently rates a buy, hold or sell. Research reports would also carry graphs plotting the prices at which an analyst recommended the shares.

Analysts will not be able to trade against their tips

The Securities and Exchange Commission (SEC), which will oversee enforcement, will allow public comment on the rules before it decides whether they should be modified.

Proposed changes in accounting rules include barring consulting to audit clients

The way forward for US accounting post Enron

The Enron debacle was huge: a $50 billion bankruptcy, $32 billion lost in market capitalisation, and employee retirement accounts drained of more than $1 billion. The lapses and conflicts of interest at Enron's auditor Arthur Andersen were equally glaring, and the firm continues to disintegrate as a consequence. Clearly, substantial reforms in accounting practice are now needed – current proposals include the following[5] items.

1. *Barring consulting to audit clients*
Over recent years, many of the big accountancy firms have become increasingly dependent on consulting fees. In 1993, 31% of the industry's fees came from consulting, but that had jumped to 51% by 1999. According to a University of Illinois study, for every dollar the first 563 companies to file financial statements after 5 February 2001 paid their independent accountants for audit work, $2.69 was paid for non-audit consulting. Puget Energy, based in Washington, paid accountancy firm PriceWaterhouseCoopers only $534,000 for its audit, but over $17 million in consulting fees, or, put another way, 30 years of audit fees in one year for consulting! Hotel group Marriott International Inc also reportedly paid Arthur Andersen just over $1 million for its audit, but more than $30 million for information technology and other services.

The situation has been similar in the UK. Over the last five years, Arthur Andersen earned 12 times more from non-audit work for British Sky Broadcasting Group than it did for checking the company's books. In 2000, PriceWaterhouseCoopers collected €14 million (£8.5 million) for its auditing services, €4 million for tax advice but €42 million for 'general consulting' on behalf of consumer goods giant Unilever.

One view is that conflict of interest rarely leads to litigation and that consulting work can provide a better understanding of the company and improve the audit. However, the potential problems and conflicts facing an accountancy firm that earns significantly more from client consulting than audit are clear: there is a danger that auditors may be less rigorous about questioning a company's accounts when that client is also offering much more lucrative consultancy work.

2 *Mandating the rotation of auditors*

Supporters of the mandatory 'rotation' of auditors argue that scandals like that surrounding US waste haulier Waste Management – where income was overstated by $1.4 billion – would never occur if the temptation to 'cook the books' was removed by periodically replacing a company's accountants with another firm. Opponents, however, say that such rotation could actually lead to more problems, since new auditors first need time to learn about a company. They prefer the current system of changing audit partners periodically but keeping the same firm in place.

However, it has been argued that rotation is relatively inexpensive to implement and the idea has been attracting attention outside the US. For example, the UK's financial watchdog, the Financial Services Authority (FSA), is considering making the mandatory rotation of auditors part of stock exchange listing requirements. At the World Economic Forum annual meeting in New York, Sir Howard Davies, the chairman of the FSA, also spoke of limiting the non-audit work accountants would be able to do for their audit clients. This came as Unilever said it was reviewing the practice of using its auditors to carry out consultancy work[6], and Walt Disney said it was separating the two functions entirely. Niall Fitzgerald, Unilever's executive chairman, is reported as saying that the Enron collapse has raised 'serious questions' about the role of auditors.

At a wider level, the European Commission has recommended that senior partners working on audits should be changed periodically, but that there should be no compulsory rotation of audit firms[7]. In a series of best practice recommendations, the Commission has produced guidelines as the first attempt to set European Union-wide standards on auditors' independence. These rules call for senior partners on an audit engagement to be rotated at least every seven years, in line with professional requirements in the UK.

3 *Imposing more forensic auditing*

When the US Public Oversight Board (POB) began its 2000 review of auditing effectiveness, it apparently brought in an accountancy 'sleuth', Central Michigan University Professor Thomas R Weirich, to undertake a study of audit failures. He found, in a review of 40 failures that led to government enforcement actions, that in a number of cases the Big Five auditors 'did not take that extra step or do that extra work' that might have uncovered the problem.

Auditors could be made to rotate ... and should ask more searching questions

It could indeed be argued that the auditors should ask more searching questions by, for example, introducing some forensic auditing techniques into the average audit. These could focus on revenue-recognition issues and the establishment of reserves – two of the most common reasons for earnings restatements. Some, however, argue such proposals might merely lead to few changes other than an excuse for auditors to raise their prices.

4 *Limiting auditors' moves to companies*

The problems associated with auditors' personnel accepting appointments in client companies has also been highlighted. For example, in 2001 the SEC took enforcement action against Arthur Andersen regarding its role as auditor of Waste Management between 1993 to 1996. Andersen had audited the firm since before its 1971 initial public offering, but from 1971 until 1997 every chief financial officer and chief accounting officer at Waste Management had, according to the SEC, previously been an auditor at Arthur Andersen. Simply a case of good friends?

Auditors' staff moves to client companies could be restricted

Unfortunately not. The SEC charged that irregularities began appearing in Arthur Andersen audits as early as the late 1980s and that in 'its original audits for 1993 through 1996, the engagement team had identified and documented numerous accounting issues underlying misstatements that the restatement ultimately addressed'. Even so, Andersen gave Waste Management's inaccurate financials its blessing, leading the company eventually to write-off $1.4 billion of previous earnings.

Audit committees could be reformed and accounting rules tightened

Of course, many companies see a similar movement between their accounting staff and audit firms and never run into problems. There are also legal obstacles in trying to limit the freedom of employees to work where they like. Yet the case of Waste Management is not unique and does demonstrate that an overly-cosy relationship between a firm and its accountants often means the numbers are not scrutinised with the necessary vigour.

5 *Reforming the audit committees*

In 1999, the SEC recommended that audit committees should be made up solely of independent directors, each of whom should be financially literate and with at least one having accounting or financial management expertise. However, when the US stock exchanges moved on the recommendations and adopted new rules for listed companies, they were entirely different. Under the New York Stock Exchange rules:

- directors on the company payroll are permitted to join the audit committee;
- former employees and their families can become directors after three years; and
- audit committee members with a 'significant business relationship' with the company are acceptable, if the board determines the ties will not interfere with their judgement.

The Enron case has helped supporters of IAS over GAAP

Interestingly, half of Enron's six-member audit committee would probably have been barred from service had the SEC recommendations been adopted verbatim. One member, for example, had a $72,000-a-year consulting contract with the company, and two others were employed by universities that received significant charitable contributions from Enron, its former chairman Kenneth L Lay, and their foundations.

6 *Cleaning up the accounting rules and enacting self-regulation with teeth*

Accounting has become increasingly complex and to many the Financial Accounting Standards Board (FASB), the industry standard setter, has been too slow to respond to these changes with new rules. For example, it has been considering rules on special-purpose entities – the off-balance sheet financing partnerships that were at the heart of Enron's troubles – for more than 20 years.

Many of the concerns were expressed in March when President George W Bush unveiled a plan to crack down on corporate executives who mislead their shareholders. According to this plan, there would be unprecedented regulation of the accounting industry and the requirement that companies disclose more detailed financial information more often. 'Toothless', said top Democratic lawmakers, who argued it merely gave a list of rules with no real remedies and failed to provide tough enforcement sanctions. For example, one proposed rule – which concerned the requirement of executives to certify financial statements – was silent about the possible consequences if these statements later proved inaccurate.

The European perspective

It has been argued that Enron would not have happened in the UK because:

- the Accounting Standards Board (ASB) requires accounts to reflect properly the economic substance of a company's assets and liabilities, and not merely to satisfy legal form as is most important in the US; and
- auditors are required to satisfy themselves that the accounts provide a 'true and fair view' of the company's financial position. This is generally a much stricter requirement than in other parts of the world, including the US.

The Enron disaster has strengthened the hand of those who favour International Accounting Standards (IAS) over US Generally Accepted Accounting Principles (GAAP)[8]. Supporters of IAS, which will become mandatory for all publicly-traded European Union companies by 2005, claim these standards would have exposed Enron's problems long before the company went bankrupt. This, they say, is because IAS are based on general principles, like the UK standards, which compel auditors to enforce the spirit of the law and not just the letter. In the case of Enron, therefore, IAS European auditors would have looked beyond the simple numbers to quiz management why it had moved assets and liabilities off the balance sheet. The auditors would then be required to exercise their own judgement about the true picture of the company's finances. Of course, auditors' judgements can vary widely and, if wrong, there may be no regulatory mechanism to intervene.

The role of the credit rating agencies

Nor have the credit rating agencies[9] escaped censure in the Enron aftermath. They were criticised, like the research analysts, for continuing to give Enron a strong rating even as the firm was sliding into bankruptcy. The problem is that as credit has continued to burgeon, the market participants and regulators have forced the rating agencies into a role they never expected. Rating agencies have long argued against the use of their credit metrics in the regulation of financial institutions, but this has arguably become more entrenched with the introduction of Basle 2[10].

The reason for the involvement of rating agencies is not difficult to understand, and an easy-to-read summary has been provided by *Treasury Today*[11]. The reality seems to be that investors like rating agencies, who are perceived as providing a usable form of shorthand and a simple designator for what is, in reality, often a complex financial position. And, although ratings can be used as too much of a crutch, it is difficult to see a realistic alternative to their use.

Credit rating agencies were criticised ... but they are liked by investors

Accounting minefields

Finally, the Enron debacle illustrates the 'accounting minefields' of which shareholders and boards of directors need to be aware. Although this area is potentially very complicated, David Sherman and David Young have identified six key 'danger zones'[12]:

1) revenue measurement and recognition;
2) provisions for uncertain future costs;
3) asset valuation;
4) derivatives;
5) related party transactions; and
6) information used for benchmarking performance.

An awareness of these accounting minefields is essential, but we should also remember Higson's message at the beginning of this article that a company is making its investors richer only if it can grow and sustain a return on capital that is greater than the cost of that capital. This proposition, moreover, is only the kind of common sense rationale any investor would use in considering a personal investment proposal. MU

Be aware of accounting minefields and remember that return on capital must exceed cost of capital

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Customers who are ‘hopelessly devoted‘

Devoted, loyal customers are the ideal, but how do you get them and keep them this way? It’s no longer just a question of satisfying customers – you now have to know them inside out, provide good service, and engage with their emotions. It all points to the need for more customer focus, research and dialogue. But you need to ask them the right questions and to know what you really want from them, according to **Susan Foreman.**

Marketing success lies, of course, in the ability to create and retain satisfied, loyal and devoted customers. Maximising their value is ensured not only through an in-depth understanding of their profile but also through the effective processing and use of that information within the organisation. This article re-examines the central role of the customer, analysing the value of long-term, devoted customers and the role they play in informing and connecting the different aspects of the firm to bring organisational success.

Organisations that watch the smaller movements in customer spending reap rewards

Clearly, customer retention remains a key marketing challenge. However, as Stephanie Coyles and Timothy Gokey[1] demonstrate, organisations that also pay attention to the smaller movements in customer spending patterns – besides just the ‘big picture’ – can reap the rewards. Chip Bell[2] states, though, that retention is not always sufficient in itself. By building on the emotional ties that a customer may feel for a particular product or organisation, he says, a firm can move one step beyond retention and encourage customer ‘devotion’.

Many organisations have the choice of either keeping their customers at arm’s length or, by softening the boundaries of the organisation, using them to inform their decisions. Matthias Holweg and Fritz Pil[3], for example, have examined the close ties between operations and marketing in certain companies. They have suggested that many manufacturers produce varied models and versions of a particular product to compensate for the difficulty in understanding customer needs. Unfortunately, they say, the more they do this the more distance they create between themselves and the customer. As Anthony Ulwick[4] argues, the customer is not only central to marketing but can, if managed properly, also play a leading role in the management of innovation, ensuring products are designed according to core customer requirements.

Retention is not enough

Great emphasis has been placed on understanding the contrasting issues of customer retention and defection in recent years. Less attention, however, has been paid to smaller changes in customer spending patterns. Coyles and Gokey suggest that, to do this effectively, companies first need to measure how loyal existing customers are, identify exactly when they change their buying behaviour and pinpoint when they begin to spend less. They refer to this process as customer migration. Just as the proponents of customer retention illustrated their approach with powerful examples of the benefits of retention, Coyles and Gokey provide examples of the management of ‘downward migration’ in the financial services sector. For example, when 35% of customers reduced their balances, these declines cost the bank 24% of its total balances.

The starting point is, of course, in understanding customers and examining those factors influencing satisfaction and loyalty. These include current customer behaviour and a broader understanding of the environmental factors, including competitive actions, lifestyle changes and so forth. In fact, there have been many attempts to classify and segment customers according to their propensity to be loyal or not to a certain brand, product or organisation, etc.

In their extensive research into 16 industries, Coyles and Gokey segmented customers into six categories of loyalty. These were then split into two groups to distinguish between 'loyalists' and 'downward migrators' (*see box, right*).

In their research, Coyles and Gokey identified the 'deliberative' type as the largest group. They, according to the authors, are the most likely to take a rational approach to their decision-making and are the most lucrative for the company. This, clearly, is an interesting observation but is only useful once a company has assessed its own customer profile. Profiles will differ by company and by industry but key factors like assessing the customer base according to frequency of purchase, amount of contact, significance of the purchase, switching barriers between competitors and differentiation between competitors can be used across most sectors.

Once in place, strategies can be initiated which identify the points of downward migration, leading to the tactics required to capture and develop their customers. Some customers will, of course, reduce their spending and ultimately leave the company. Others, though, say Coyles and Gokey, will stay and here opportunities for upward migration can be realised.

Six categories of customer

Loyalists

- *Emotive loyalists* are those convinced that they have made the right decisions about a brand, product, etc, and have no plans to switch to an alternative provider.
- *Inertial loyalists* feel that they made a good decision at the time of a purchase and do not want to 'be bothered' to move.
- *Deliberative loyalists* are active decision-makers who regularly reassess their choices and are happy with their decisions.

Migrators

- *Lifestyle downward migrators* have experienced a change in their personal circumstances and have either new or conflicting needs.
- *Deliberative downward migrators* have reasons behind their changing spending patterns and choose another viable alternative.
- *Dissatisfied downward migrators* are dissatisfied with their experience and seek alternatives.

Source: Coyles and Gokey

Devoted customers

How would you describe your customers? Are they faithful, enthusiastic, committed, devoted, even? Bell speaks of the seemingly paradoxical 'obnoxiously devoted' customer and outlines a model of 'customer love' which, if properly harnessed, can be used by the business to build a strong bond with the customers so that they 'will forgive you when you make mistakes, defend you to others... give you candid feedback... will never sue... and, pay more'.

Totally unrealistic? Actually, no, if the customer feels committed and deeply attached to the relationship and the company. Bell suggests generating this through an approach which attempts to build emotional attachment and more deep-rooted allegiances than are possible through simpler, customer-focused strategies.

Motorcycle manufacturer Harley Davidson, hotel chain Ritz Carlton and entertainment group Disney are all classic examples of companies with 'obnoxiously devoted' customers. The following 'E' factors were among the key issues outlined in the research for companies seeking to create and maintain 'devoted customers':

- *enlistment* or the inclusion of the customer where appropriate in the service delivery will help to build customer commitment;
- *engagement* and the 'dramatic listening' to feedback from the customer and the consequent responsiveness helps to build appreciation and belief;
- *enlightenment* or the opportunity to learn more about a product or service can enable customers to see the full potential which can be derived from the product or service. Ultimately, this can help build and develop customer confidence;
- *entrustment* and reliability are crucial elements in building a bond of trust in the development of customer service;
- *empowerment* – consistency in, for example, service delivery helps to reduce customer uncertainty and build confidence;
- *enchantment* or exceeding customer expectations with unexpected gestures or surprises which complement the service can also lead to improved employee satisfaction and customer loyalty; and
- *endearment* and, in particular, generosity, is valued by customers.

'Deliberative' customers are the largest group

'Customer love' can be used by the business to build a strong bond

This is not a conventional marketing approach and touches on the emotional aspects of marketing and the management of relationships. Nor is its implementation straightforward, as it requires management support and a culture that can embrace these more innovative marketing techniques.

The customer's role in innovation

Most managers will, of course, resolutely answer in the affirmative when asked if they are customer-focused. After all, most would say, it is simply common sense and good business practice. However, Ulwick's research into the impact of customers on innovative behaviour in organisations reveals an organisational dilemma. Whilst the majority (71%) of companies taking part in this research said they were satisfied with their ability to listen to the customer, they were equally concerned about the poor reactions from customers to new product development.

Companies are not asking customers the right questions

In fact, says Ulwick, companies are not asking their customers the right questions and researchers often ask customers to provide their own solutions when they themselves lack the ideas. This, he states, can lead to the failure of new product developments. Instead, he claims, companies should concentrate on asking about the underlying customer needs and wants and the precise outcomes they require.

So, ultimately, it is the difference between merely being informed by the customer instead of being customer-driven. Yet, says Ulwick, there are also a number drawbacks when listening to customer solutions:

- they can undermine the innovation process when customers are not aware of the technological possibilities;
- they can lead to incremental rather than radical innovation and change;
- they can expose the company to competition that is customer-driven;
- they can lead to a concentration on 'me too' products;
- they can lead to an unnecessary focus on a vociferous group of 'lead users'. Often, the view of the 'average' customer is most important to ensure innovations and new developments have wide appeal; and
- there can be resentment of new product developments if the improved version leads to an increase in costs.

Research using skilled interviewers can help assess customers' needs

How, then, does a company avoid such difficulties? Ulwick suggests a simple approach to refocusing research, describing a process used by Cordis, a medical device manufacturer. Its qualitative approach is based on the results of in-depth customer interviews. This requires the careful selection of the customer groups included in the research and then, a thorough analysis of the process or activities that lead to the development of the product or service throughout the interview.

The approach requires a skilled interviewer who can separate the outcomes from the solutions and then format the outcomes into meaningful phrases which include the type of product improvement required and a unit of measurement. Typically, this process would take two hours to do well.

Cordis believed it had captured 96% of customers' desired outcomes from 30 interviews. After review, it identified four key themes which were then rated for importance and used to 'jump-start' its innovation process. According to Ulwick, Cordis specifically designed products to match the outcomes and was able to dominate the different market segments. This approach, it seems, took it from the conventional competition levels on geographic segmentation and price competition etc to one where the outcomes matched what the customers really wanted.

Push and pull

Early marketing teaching asked us to look at the contrasting approaches of 'push and pull' strategies – balancing the myriad of customer needs and ensuring products reach them at the right time, the right place and at the right price. Clearly, however, the inexact science of predicting customer demand often led to missed sales, excess capacity and an unhappy flurry of incentives, discounts and sales to reduce inventory.

Holweg and Pil, however, have sought to highlight that strong links between production and customer management need to be at the heart of the manufacturing process. They criticise push strategies and what they call the destructive cycle of 'make to forecast' processes. For them, two forces in particular can move the organisation away from the customer. Initially, the push to focus on volume in the search for economies of scale can lead to products being sold at discount. Or, there can be an emphasis on selling the current stock and not what the customer actually requires. Ultimately, of course, 'specials' or tailored products are limited because the system is set up for volume and these products take longer to produce.

The solution, they believe, are 'build-to-order strategies', where the three dimensions of process, product and volume flexibility enable the organisation to maximise benefit to the company and the consumer along the supply chain. This, Holweg and Pil state, is "an encompassing and customer-centric view that lets companies react quickly to demand changes, reduce inventory costs and decrease discounting". Each element of the 'build-to-order' approach of process, product and volume has been broken down into three key elements:

1) 'process' must consider the need to link customer needs to production and to manage the sales and demand data so that real rather than artificial orders are passed through the chain, and that inventory is not produced as a way of managing production. Indeed, in addition to managing the data, the real position with regard to order status should be clear to all suppliers;
2) the company should be able to adapt its products to the customer's specification. Their recommended approach is to do this at a point in the production process that is close to the customer, to balance stable production with customer needs. This can be achieved if the company can identify the critical parts of the product the customers want customised; and
3) in order to 'build-to-order', the production volumes need to be managed so that there is less dependency on working to 'full capacity'. Rather than set working hours, more flexi-time could be used to manage the changes in demand in a cost effective way for worker and the company.

However, to do this the production facility itself needs to be able to shift with demand patterns. Indeed, a generally more active management of demand, as often seen in the service industry, could be initiated.

Most companies, however, do not have the luxury of beginning their operations again from scratch, and the transition from their existing approach to a 'build-to-order' system can require significant planning. The first steps require a clear understanding of customer requirements and, then, successfully transmitting that information clearly to all members of the chain. The emphasis would be on making lead times shorter and meeting customer expectations on delivery requirements. The strategy might then be to introduce 'build-to-order' on existing business – a risky approach but one that Holweg and Pil claim can deliver the highest returns. Alternatively, this approach could be introduced to new 'customised' products.

One solution is a 'build-to-order' strategy

Naturally, the benefits are restricted but there are opportunities to review and learn and to develop a platform for more widespread developments. Alternatively, for 'standard' products that can be customised, Holweg and Pil suggest a hybrid approach that could be used slowly to decrease dependency on products in stock until they are completely replaced by built-to-order products.

The importance of the customer is a well-developed marketing theme, but the journey to customer-orientation throughout the business is fraught with difficulties. However, it is achievable. The careful assessment of consumer spending patterns can help stem defections and develop profitable customers. Customer requirements can also be met through close analysis of their needs and desired outcomes and, where these are communicated to operations, then processes can be designed to deliver tailored services and products. Whether this leads to customer love and devotion is another challenge. MU

Making the business customer-oriented is difficult but achievable

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When HRM reaches across borders

As globalisation proceeds, opposition grows – so how can it be managed with a 'human face'? International human resource management (IHRM) has to deal with great complexity in laws, cultures and politics, both national and organisational. Which practices should be standardised, and which left to local management? Is there a trend to convergence in practice? Or are there national values and behaviours that it would be better not to change? **Richard McBain** discusses the issues.

> Management of HR is now increasingly vital at both national and cross-border level

Technological innovation and the development of multinational organisations have been critical factors in the globalisation of the world economy. Unsurprisingly, the management of human resources is now increasingly vital at both national and cross-border levels. In a recent review, Randall Schuler et al[1], for instance, argue that international human resource management (IHRM) will "increasingly become a source of competitive advantage in global as well as multi-domestic markets". Yet, as they point out, the challenge is not an easy one, since IHRM is "substantially more encompassing than domestic HRM".

This article will consider recent research in IHRM, including issues such as the impact and influence of national cultures on HRM practices, the links between national culture and leadership, and evidence of the global convergence of HRM philosophies, policies and practices.

It begins, however, with analysis of a fundamental issue for the multinational corporation (MNC) – that of balancing the need for 'differentiation' against the need for co-ordination and control in the pursuit of global competitiveness.

Developing a culturally synergistic approach to IHRM

> There are three approaches – adaptive, exportive and integrated

International human resource (IHR) professionals can, in fact, choose between three basic approaches when defining the relationship between the HR practices of the parent and the 'local' organisations:

- *adaptive* – each affiliate develops its own HRM system reflecting the local environment. This provides the advantage of differentiation but can, potentially, lead to a lack of coherence;
- *exportive* – the parent company's HRM system is transferred to its different affiliates, providing internal consistency but also, possibly, inflexibility; and
- *integrated* – taking 'the best' HRM approaches and using them throughout the organisation, thereby combining the characteristics of the parent company with those of affiliates, but risking the possibility that some practices may not be suited for certain contexts.

In reality, the IHR professional can also often mix different approaches, adopting varying policies and practices for different areas, tasks or groups of employees. Maddy Janssens[2] argues, however, that three criteria should apply when deciding between these approaches:

1. *the forces for global integration and for local adaptation* – ie the need for integration or inter-unit linkages versus the need for responsiveness or differentiation for local environment, arising from strategy, top management belief, international life cycle, the strategic role of certain groups, and the legal environment;
2. *the cultural component of HRM* – ie the differences in cultural values embedded in HRM policies and their likely impact on the parent and affiliates; and
3. *the power dynamics within the MNC* – ie the acceptability of the decision to the parent and to the affiliates.

In addition, Janssens also advocates an alternative, 'culturally synergistic approach' between parent and affiliate which combines existing models with a problem-solving process. This, he argues, can lead to innovative HR practices and consists of seven steps:

1) explaining the need for an integrated IHRM practice;
2) developing a 'superordinate' goal – a broadly-defined goal that intends to provide a general direction rather than a specific outcome, thereby allowing for the incorporation of individual differences;
3) exploring the best practices of different cultures;
4) assessing the cultural appropriateness of solutions;
5) consensual decision-making;
6) taking action steps; and
7) evaluating the outcomes of the action steps, from each culture's perspective.

Such an approach can, of course, require significant time and effort commitment. But, says Janssens, there may well be commensurate benefits. The "advantage of the culturally synergistic model lies in simultaneously considering the need for global co-ordination, the recognition of the cultural 'embeddedness' of HRM, and the importance of the power and autonomy of the local affiliates".

The importance of the CEO's international assignment experience for MNCs

According to the resource-based theory of the firm, a business's competitive advantage is derived from the unique bundle of resources it possesses. This argument has also been extended to consider a company's dynamic capabilities, or unique ability to achieve new and innovative forms of competitive advantage in changing conditions.

Mason Carpenter, Gerard Sanders, and Hal Gregersen[3] note that, even among MNCs, "CEOs with international assignment experience are surprisingly rare". Yet, they argue, such experience can have a direct and positive impact on company performance as measured by both return on assets (ROA) and stock returns.

The full impact of this resource comes, they say, not just from it being valuable, rare, and difficult to imitate, but also from it being 'bundled' with other, complementary resources. These include:

- *top team international assignment experience* – the CEO will, for example, typically share tasks and power and it can often be easier to implement global strategic imperatives with a team that shares a similar background; and
- *MNC global strategic posture* – or the degree to which a company is dependent on foreign sales and production and to the geographical dispersion of this dependence.

Interestingly, the authors also found that the greater the company's global strategic posture, the stronger the relationship between a CEO's international assignment experience and total pay. As noted above, this research also found support for the resource and dynamic capability arguments that the CEOs with such valuable and rare international assignment experience create value both for their firms and themselves. Organisations, therefore, should take steps to assess resource fit and identify the critical human-capital resources that are essential to resource bundling.

CEOs with international assignment experience create value for their firms and themselves

HRM in Asia – a case of convergence?

Chris Rowley and John Benson[4], in their study of four Asian countries (Japan, China, Korea and Thailand), and Rowley and Johngseok Bae[5], in a study of Korea, considered the issue of the global convergence of HRM. This convergence, its proponents argue, is a result of industrialisation, the impact of technology and communication and environmental factors, ultimately leading to 'universalistic' HR tendencies. Others, however, believe different approaches to HRM will continue because of national cultural and institutional differences.

Technology aids convergence

Brian Becker and Barry Gerhart[6] have defined three different levels of HRM:

1) *system architecture* – the guiding principles and basic assumptions ('deep structure');
2) *policy alternatives* – the mix of policies consistent with 'architectural fit' and internal/external fit; and
3) *practice/process* – best in class implementation and techniques given appropriate decisions at the system architecture level.

There are three different levels of HRM – system architecture, policy alternatives and practice/process

One assumption of this 'model' is that bundles of practices should be aligned with each other and should also be consistent with the 'architecture.'

Clearly, this framework is similar to John Storey's[7] distinction between 'beliefs and assumptions', 'strategic qualities and managerial roles', and the 'key levers' which Rowley and Benson have used to identify the level of convergence in the four Asian countries. In fact, according to their research, an 'ideal' HRM model, based upon assumptions of universalism and best practice at the level of beliefs and assumptions, was not often adopted in these countries. Rather, the reliance on rules specifying mutuality tended to restrict initiatives and do little to encourage commitment. They argue that, finally, the architecture or deep structure has not significantly altered and that business structures, culture and shared mindsets remain important barriers to convergence.

Reliance on rules specifying mutuality tended to restrict initiatives

However, the adoption of the HRM model is most significant at the individual key levers, or practice/process level. Even if there was significant variation between the four countries and enterprises within each, most of the countries had, or were moving towards adopting the following practices:

- freedom in personnel selection;
- individual performance-related pay;
- harmonisation of work conditions;
- individual contracts;
- teamwork; and
- continuous training.

Rowley and Benson conclude that "convergence appears to be more about individual HRM practices than system change". Furthermore, in place of convergence, it "appears that different configurations or bundles of HRM practices are emerging in these countries as a result of the pressures of internationalisation and globalisation". They also argue that there was a general lack of a strategic approach to HRM in these countries and little reliance on line managers to play a key role in the management and development of employees. The "interaction between various business contexts and cultures means that in each country a 'unique' HRM approach will develop".

There is a complex set of relationships between leadership, culture and organisations

Rowley and Bae provide a complementary and more detailed study of the impact of globalisation on HRM in South Korea. Importantly, however, changes in Korean HRM have been influenced by Japanese occupation, US post-war influence, and the ending of authoritarian and military rule in 1987, and not just the country's recent economic transformation. Nevertheless, in recent years Korea's strong, rigid, internal labour market with lifetime employment and seniority-based remuneration has shifted greatly to a more flexible and external labour market which incorporates performance-based elements.

However, say the authors, there remain in Korea significant cultural barriers to HR convergence. For example, collectivism, deference and neo-Confucianism are impediments to the universalism underpinning HRM. Second, at the organisational level, there is an obvious gap between the swift changes in HRM practices and the conservative shared mindset of organisations.

Accordingly, while implementing certain changes may be relatively easy in practice, they may not necessarily be generally accepted or 'internalised'. Furthermore, they say, organisations and their HR professionals should be aware of the role of traditional culture. In Korea, the community-based traditions, (characterised by community orientation, with paternalistic relationships, and norms of harmony, care and equality underpinned by a Confucian heritage) were partly the foundation of past successes.

Safeguarding such traditions may well, they say, contribute to future success. Their recommendation, therefore, is to avoid blindly discarding systems on the basis of fads and fashions and to develop an amalgam of useful Korean-type factors with the selective adoption of other practices.

Leadership and global cultural clusters

Project GLOBE[8] aims to describe, understand and predict the impact of specific cultural variables on leadership and organisational processes and the effectiveness of these processes. It involves 150 researchers focusing on the theme of culture and leadership in 825 organisations in 61 countries. Two of the projected three research stages have now been completed.

What the research model[9] suggests is, unsurprisingly, a complex set of interrelationships between leadership, culture, and organisations. Leadership, here, is defined as "the ability of an individual to influence, motivate, and enable others to contribute toward the effectiveness and success of the organisations of which they are members". Similarly, culture is the "shared motives, values, beliefs, identities, and interpretations or meanings of significant events that result from common experiences of members of collectives and are transmitted across age generations". Interestingly, the research also sought to measure both shared values and judgements of 'what should be', and also the 'what is,' or current practices. Nine cultural dimensions were employed to examine national cultures:

1) *uncertainty avoidance* – the extent of reliance upon social norms, rules and procedures to alleviate the unpredictability of future events;
2) *power distance* – the degree to which power is expected to be distributed equally;
3) *collectivism I (societal collectivism)* – the degree to which the collective distribution of resources and action is encouraged;
4) *collectivism II (in-group collectivism)* – the degree to which individuals express pride, loyalty and cohesiveness in their organisations or families;
5) *gender egalitarianism* – the extent to which gender role differences and discrimination are minimised;
6) *assertiveness* – the degree to which individuals are assertive, confrontational and aggressive in social relationships;
7) *future orientation* – the degree to which individuals engage in future-oriented behaviours;
8) *performance orientation* – the extent to which encouragement and reward are provided for performance improvement and excellence; and
9) *humane orientation* – the degree to which encouragement and reward are provided to individuals for being fair, altruistic and caring towards others.

The research identified 10 distinct cultural clusters[10], or groups of countries that share many similarities (*see box, bottom right)*. In addition, six culturally generalisable dimensions of leadership were identified from the data: transformational/charismatic, team-oriented, self-protective, participative, humane and autonomous.

Due to the extensive geographical scope and findings of this research, only the key findings of two clusters are discussed here.

The Southern Asia cluster[11] (comprising India, Indonesia, Iran, Malaysia, Philippines and Thailand) is defined by a high power distance, humane orientation, group and family collectivism, and low gender egalitarianism and assertiveness. However, it also aspires to much stronger future- and performance-orientations, strong institutional collectivism, greater assertiveness and much lower levels of power distance. Charismatic, team-oriented and humane leadership is valued. Visionary, diplomatic and inspirational team-builders with high levels of integrity are also likely to make the most effective leaders here. The authors also argue that "a craft-based apprenticeship model of organisation with value-based inspirational mentors... is likely to be appropriate for the development of firms as social communities in this region".

The Anglo cultures[12] (Australia, Canada, England, Ireland, New Zealand, South Africa, and the USA) are male-dominated, performance-oriented societies that value individualism. These societies emphasise individuals achieving their goals without the over-use of structure, power and hierarchy, and there is an inherent dislike of rules and authority. However, the authors argue, these cultures do want to be more family oriented, have a greater collective focus and give more weight to gender equality. Leadership in these countries, ideally, is charismatic and inspirational. However, it also needs to demonstrate a team-oriented and participative style which allows a team its own structure and autonomy. Indeed, there seems to be a strong desire within this culture for a more group-oriented workplace.

Anglo cultures are male-dominated, performance-oriented, valuing individualism

'Culture' versus 'employment system'

While the research considered so far has demonstrated the importance and persistence of culture, Yasuhiro Okabe's[13] research provides an alternative perspective. In a study of managers working for large Japanese multinational organisations in both Japan and Britain, the author considered whether attitudinal variations are based more on the differences of each country's employment system rather than their culture. Thus, while the cultural perspective might emphasise that the Japanese are group-oriented and

Variations in employmernt systems can influence attitudes

10 cultural clusters

- Anglo cultures
- Latin Europe
- Nordic Europe
- Germanic Europe
- Eastern Europe
- Latin America
- Sub-Saharan Africa
- Arab cultures
- Southern Asia
- Confucian Asia

Source: Project GLOBE

Differences between Japanese and British managers were not as extensive as the cultural thesis would suggest

company-centred, and that the British are individualistic and family-centred, the employment system approach notes the distinction between the organisation-based system of Japan and the market-oriented system of Britain.

Okabe also considered the importance attached to work values such as:

- level of pay;
- job security;
- fringe benefits and corporate welfare;
- job variety;
- opportunities for learning new skills;
- being group member friendly;
- whether group members took a personal interest in you;
- family time; and
- professional orientation.

The study found that the cultural differences between British and Japanese managers were not as extensive as the cultural thesis would suggest. Indeed, the differences appeared insignificant when demographic variations such as age were considered. Moreover, the stereotypical image of the Japanese worker as having a high social orientation and unconditionally prioritising work over family was observed only among certain groups such as shop-floor managers and senior managers.

By contrast, the younger generation of Japanese graduate managers seemed to value family time as much as its British counterpart. It seems, therefore, that at least some cultural differences erode over time. Moreover, some attitudinal differences, such as the high professional orientation of British managers, may be seen more as a rational response to a different employment system – here a market-oriented one – than simply attributable to national culture alone. MU

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Has strategy changed?

The bursting of the dotcom bubble and the struggles of even long-standing companies in IT and telecoms prompt questions about strategic thinking. Are the main ideas in strategy still valid? Is it only the business environment that has changed? Or do we need a fundamental re-think? Shortage of capital is no longer the problem – companies are awash with it. Today the need is for continual organisational alignment, focusing resources on where competitive advantage can be achieved and the company's human talent can be effectively deployed. **Ian Turner** explains.

In a previous *Manager Update* we asked what remained of the 'new economy' now that the dotcom bubble has burst and even long-standing companies in the IT and telecommunications sector are struggling. Clearly, say 'old economy' advocates, we should now be promoting traditional strategies based on 'classical' economics and the importance of distinct positioning in the marketplace. Not necessarily, argues Kathleen Eisenhardt, one of the foremost exponents of complexity theory in its application to corporate strategy. Although she concedes the obvious impact of digital technology in industries like telecommunications and software, she argues that the internet has been over-hyped in its impact on economics and strategy[1].

In fact, she believes a far more powerful force has been responsible for transforming the business environment: globalisation, and not web economics, she says is the real driver of the new economy. In this new dynamic playing field, some fundamental principles of strategy remain the same: strategy is still about being different. But, as Eisenhardt puts it, *what constitutes that strategy has changed* – "the new strategic watchwords are simplicity, organisation and timing"[2].

The byword for strategy in complex situations is, paradoxically, simplicity. Just as in nature, where complex phenomena – like the way a flock of birds can fly in perfect formation – can often be reduced to a few simple rules, so Eisenhardt believes that strategy in complex and unpredictable environments should also seek to operate on the basis of simple precepts. These might be, for example, 'maintain the brand' or 'always acquire companies with compatible technology' and should then allow managers freedom to manoeuvre within them. In fact, Eisenhardt's second principle is that strategy *is* the organisation. The ability of an organisation continually to re-align itself organisationally is, she says, the key to success in a fast-moving business environment.

Finally, Eisenhardt believes that new organisational strategy should be dynamic and open to change. However, much of the change which companies even in fast moving industries have to undertake is likely to be relatively small and at the operational level. Large, 'transformational' change is usually the exception rather than the rule. Clearly, then, successful strategies should address both these small, incremental changes as well as the more radical 'transformational' shifts.

The internet has been over-hyped in its impact on economics and strategy

Competitive advantage through people

In the late 1980s, Sumantra Ghoshal and Christopher Bartlett first coined the term 'trans-national' to describe large corporate entities operating internationally that were able both to "think globally and act locally". More recently, they have studied how such companies have tried to adapt to today's information-based, knowledge-driven and service-intensive economy[3]. One of the biggest barriers to organisational transformation, they conclude, is that all too often senior management has an out-dated understanding of strategy.

Too often, senior management has an out-dated understanding of strategy

The authors see the strategic focus of business as shifting successively from defending product/market positions in competitive markets, to sustaining competitor advantage by possession of superior resources and competences, to the current era of continuous corporate renewal through superior human

A scarcity of talent and ideas , not capital, is the main problem

and intellectual capital. Yet, they complain, too many of today's managers are "trying to implement third generation strategies through second generation organisations with first generation management"[4]. A scarcity of talented people and ideas – rather than capital – is, they say, the main problem today. Moreover, strategy is now less about 'value appropriation' – capturing the maximum economic value through defending your position in the marketplace – than actually about *creating* value. Ghoshal and Bartlett believe, like Eisenhardt, that the strategic responsibilities of senior management have now shifted from strategy content to organisational context. In particular, they cite the need for senior management to articulate properly a company's purpose, define its processes and recruit key people.

Aligning strategy and HR

Organisational strategy can only work if the HR function is fundamentally transformed

However, organisational strategy can only be effective in this new era of 'competition for talent and dreams' if the HR function is fundamentally transformed. Clearly, due to the potential implications, the recruitment of key people now needs to be treated with the same – or even more – rigour as companies formerly devoted to capital expenditure decisions. Ghoshal and Bartlett point, for example, to companies like Microsoft and McKinsey that have developed aggressive strategies for building human capital. Recruiting the right people, however, may not always be enough. The next challenge is to ensure that the company "actively links, leverages and embeds the pockets of individual based knowledge and expertise"[5].

Many employers prefer the flexibility of temping and outsourcing HR activities

Knowledge pooling, however, is unlikely to occur simply through a technological fix like an intranet or a groupware system, indeed such attempts often end in frustration. Instead, Ghoshal and Bartlett point to other, informal, methods such as the 'peer assists' idea introduced by British Petroleum (BP) in the 1990s – a scheme whereby managers in different parts of BP's organisation could compare experiences and share ideas.

Finally, a company's HR practices must lead to a 'bonding' between key employees and the company. Persuading people to 'commit' to the organisation and its values implies, of course, building trust between both parties. It also means that senior managers have to demonstrate a clear personal commitment to the organisation's purpose and reflect this in their day-to-day work – in other words, senior management has to 'walk the talk'.

The changing nature of employment

Ghoshal and Bartlett's ideas are clearly interesting, taking a trend in modern writing on strategy and pursuing it to its logical conclusion. Yet, although their conclusions may be important, they aren't perhaps all that original. Surely, now, most companies realise how important managing talented individuals is, even if they don't always make a good job of it? Peter Drucker, on the other hand, is usually able to provide a challenging new perspective and counter-intuitive insight into management problems, and his latest contribution[6] is no exception. In it he examines the rise in temporary employment (he estimates that worldwide between eight and 10 million people are placed as temporary workers each day and 70% of them work full time).

He then compares this to a related development – the rise of the 'professional employee organisation' (PEO) in the US during the 1990s. These PEOs, in fact, operate as outsourced HR departments for large companies. They are growing rapidly in the US and he expects them to be co-employers of around 10 million US workers by the year 2005. According to Drucker, these PEOs are so popular because they give employers much greater flexibility in an era where the rules and regulations governing employment have been burgeoning. Apart from the direct costs of satisfying employment legislation – equivalent to about a 25% surcharge on the top of employee wages, healthcare and insurance and pensions in the US – excess management time is also often absorbed considering employment law and practice.

Add to this the ever-present threat of employment-related lawsuits, particularly in the litigious US, and there seems little surprise that employers now think twice about adding to the headcount. Many, it would seem, instead prefer the flexibility of temping and outsourcing HR activities. As Drucker memorably expresses it, "they no longer chant the old mantra – people are our greatest asset – instead they claim – people are our greatest liability"[7].

Drucker, himself, seems in two minds about the value of outsourcing and PEOs. Ghoshal and Bartlett believe outsourcing and temp services are unlikely to confer any long-term competitive advantage – since such actions can be easily emulated by competitors. For Drucker, though, what is most important is not an employee's actual work status – be it temporary or permanent – but more the relationships executives have with their knowledge workers. In fact, he actually sees a lot of merit in a system which frees managers from the grind of employment-related paperwork and argues that, in the long run, PEOs will also make more sense for the knowledge workers themselves.

Knowledge, he also argues, is only effective if it is specialised, but in any organisation – even a large one – there may be need for only a small number of specialists at any one time. Therefore, career advancement opportunities within such an organisation – a hospital for instance – are likely to be limited. An outside company which co-employs may therefore be able to offer much greater career opportunities because of the economies of scale it enjoys, and have greater retention rates.

For Drucker, the key to this is how the organisation manages its knowledge workers and thus, ultimately, his conclusions are very close to Ghoshal and Bartlett's. If, as he argues, it is impossible for an organisation to hire more than a handful of the 'better people', then it needs to concentrate on getting more out of the ordinary people.

Organisations in future will need to focus on the productivity of their most precious capital, ie their knowledge workers, whether these workers are actually employed by the organisations directly or indirectly. As Drucker concludes "employees may be our greatest liability, but people are our greatest opportunity"[8].

Do you have a well-designed organisation?

However, while analysts may speculate on the future of the psychological contract between employee and employer, many managers have to tackle more immediate, thornier problems of, for example, ensuring they have a well-designed organisational structure. Michael Goold and Andrew Campbell have produced a short primer for executives faced with just such a task[9]. Their nine tests of organisational design can be used for evaluating existing structures or creating new ones. Four of these are fairly fundamental 'fit tests', whereas the next five 'good design tests' allow companies to refine, design and address any potential problem areas. Space prevents us from reviewing all nine tests here, but the first four tests – the fit tests – are most fundamental and worthy of note.

Organisations will need to focus on productivity of knowledge workers

1. *The market advantage test*
Ideally, a single unit should be dedicated to a single segment and, whilst it is clearly possible for one unit to focus on more than one segment, having no unit responsible for a particular segment or more than one unit responsible for the same segment is likely to be flawed and confused in practice. Similarly, the organisational design should support the company's key sources of competitive advantage. However, if this involves collaboration across organisational boundaries like, for example, bringing a product more quickly to the market, the company should be aware that this is always more difficult than intra-unit collaboration.

2. *The parenting advantage*
Companies should list the ways in which the centre adds value to the operating companies and then ensure that the organisational structure facilitates these so-called 'parenting propositions'.

Four 'fit tests' provide a guide to good organisational structure

3. *The people test*
Here, the organisational structure should ensure that for the key members of the organisation, appropriate responsibilities are allocated and reporting relationships agreed. Key jobs in the structure need to be staffed by the best people. As Goold and Campbell put it "a design that cannot be staffed with competent managers should be abandoned"[10].

4. *The feasibility test*
This means identifying the constraints – external and internal – that could prevent the successful implementation of the design. So, for example, in some companies their legacy systems might provide powerful constraints to organisational changes or the corporate culture can limit the available design choices.

There is much of interest in the remaining five tests: ensuring, for example, that effective controls are incorporated in the design, that specialist units do not have

For most companies, organisational design is an oxymoron

their cultures overwhelmed and that units can collaborate amongst themselves effectively are all worthy of note. Ultimately, as Goold and Campbell point out, a well-designed organisation has clearly to be flexible enough to adapt to change. For the most part, though, the authors are merely content to highlight issues and point out trade-offs, being only notably prescriptive in the number of levels in the organisation – what they refer to as the 'redundant hierarchy test'.

Indeed, both writers are well known for pointing out the value-destroying effects of many large corporate centres, and reiterate that decentralising decisions to operational units is key. They also urge companies to identify clear and distinct 'parenting propositions' for each of the levels in the hierarchy so that no particular level is redundant. As a rule of thumb, they argue that, to cover the costs of each extra layer, a company should assume that it would be capable of improving performance of any units reporting to it by at least 10%. Of course, although decisions on organisational design are ultimately a question of judgement and opinion, the process can and should be analysed more rationally. As Goold and Campbell put it "for most companies, organisational design is neither a science nor an art – its an oxymoron"[11].

Unbundling of the unbundled

A second wave of disaggregation is about to occur in capital-intensive utilities

In earlier issues of *Manager Update* we discussed how industries have become unbundled or disaggregated, typically as a result of digital economics. Now, say David Birch and Eileen Burnett-Kant, a second wave of disaggregation is about to occur in capital intensive utilities[12].

For example, the authors argue that companies in these industries are being increasingly disaggregated into three separate functions – asset ownership (pipelines in the gas business, for example), asset management (overseeing the operations, maintenance and upgrading of the pipelines), and service delivery (the actual day-to-day supply of gas through the pipes). As with all outsourcing, the logic is built around economies of scale and efficiencies through specialisation. Separating the businesses should, the theory goes, make the operations more transparent and encourage the disaggregated companies to build on their capabilities and expand into new markets. The authors cite the Australian natural gas distribution network as an example of this 'second wave disaggregation', and believe that huge savings in cost efficiencies can result.

Perhaps mindful of railway privatisation in the UK, however, they also point to the possibility of accountability being blurred if the system failed due to separation of tasks. MU

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The Institute of Chartered Accountants
in England and Wales,
Chartered Accountants' Hall,
PO Box 433,
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