ICAEW FINANCE & MANAGEMENT FACULTY

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# FINANCE & MANAGEMENT

"THERE IS MORE THAN ONE WAY OF LEADING. NO ONE SIZE FITS ALL" PAGE 18

**By association**
Setting up joint partnerships

**Procurement fraud**
Don't wait until it's too late

**Risk in perspective**
Strategic success

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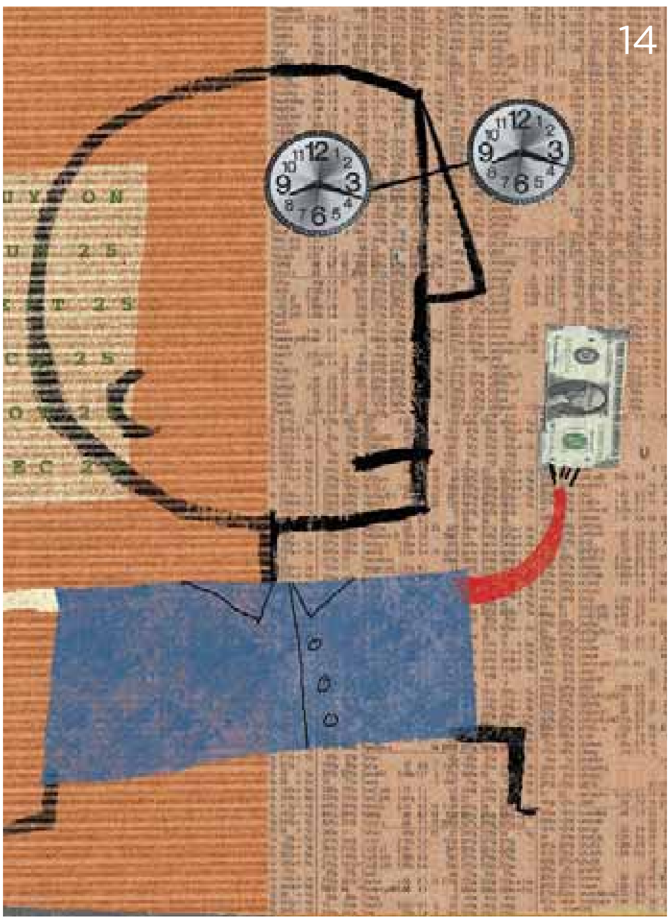

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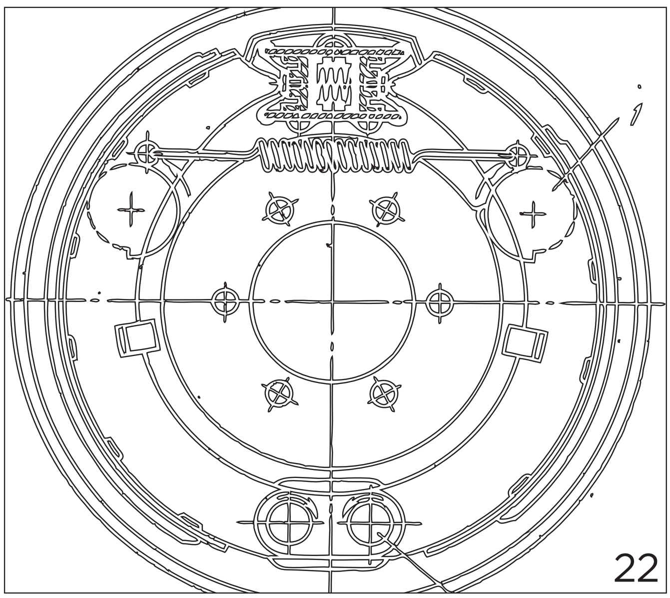

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"I've learned I can't always control what happens to me, but my response is entirely within my control"

**Bren Hutchinson**
is Director of Finance at Peel Ports

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# Leadership lessons from the Olympians

As you read these words you may still be thinking about the success of the London 2012 Games. With countless personal bests and an extraordinarily high standard achieved by the Olympians this summer, there are some noticeable parallels which can be drawn between elite sporting athletes and successful business leaders.

Some of the common qualities include mental toughness, having the ability to visualise what the future may hold, staying cool under pressure and a resilient mindset. These qualities, along with perseverance, tenacity and a keen sense of team spirit, are crucial to success.

As the economic climate continues to operate under a cloud of uncertainty, business leaders are under constant pressure to find innovative ways to stay ahead of the competition. With a vast number of businesses desperately trying to find the right talent to fill the skills gap, there have been some predictions of a shortage in future business leaders.

This month's cover story (on page 18) attempts to address this issue by placing a spotlight on the critical skills you must develop to make a successful transition from a manager to leader. Although leadership and management go hand in hand, the two are not the same and Dr Mark Pegg highlights some of the distinguishing behaviours and characteristics. For example, leadership is about being, not about doing – a good manager will need to have the ability to develop an unwavering vision of success, be able to communicate their vision with clarity and must be able to create effective teams that will foster an environment of shared collaboration among its team members.

We also feature (on page 8) a fascinating extract from Rick Payne's diary – the faculty's finance direction programme leader. Rick shares an intriguing insight into some of his key observations during the promotion of ICAEW's thought leadership work around Asia. Plus, we have the annual feature on the faculty committee (on page 9) where ideas and opinions are shared on some topical matters relating to the economic environment and the faculty.

Finally, our sincere thanks for their huge contribution go to Carolyn Bresh, Simon Jones and Tony Powell who have stepped down from the faculty committee in order to take up positions on ICAEW's new Business Committee. Fellow member Rob Thompson will be joining them whilst also remaining on the faculty committee. We would also like to offer our congratulations to our new chair, deputy chair and vice chair respectively: Dr Philip Smith, Rob Thompson and Jonathan Teller who were unanimously elected into office. For further details, refer to the faculty news on page 5.

**Jennifer Chong**
Technical manager



ICAEW FINANCE & MANAGEMENT FACULTY

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Annual membership of the Finance & Management Faculty costs just £85. For more information and to join see icaew.com/fmjoin

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For information about forthcoming faculty events, please see the flyer in this mailing or visit icaew.com/fmevents. For all enquiries contact the events booking line on +44 (0)1908 248 159.

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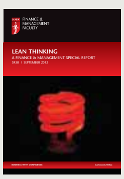
# From the faculty

## SPECIAL REPORT: LEAN THINKING

With the ever-changing demands on businesses to become more efficient and productive, finding ways to maintain a competitive advantage can be a huge challenge. As a result, more organisations are applying a lean philosophy, which focuses on a waste-free environment while maximising customer value. The lean principles, which originated from automobile manufacturer Toyota, are now being applied to a wide variety of industries.

Our latest special report outlines the lean framework and aims to provide you with the associated tools to get you started with applying the lean concepts to your organisation. This multi-author report provides practical guidance on the application of lean manufacturing concepts to service organisations, lean in accounting and lean in the finance function.



**To read the full report, see icaew.com/fmsr38**

## COMPETITION WINNER

The lucky winner of the competition in the July/August issue of *Finance & Management* magazine is Sally O'Neill.

Sally wins a month-long loan of a Lexus GS F Sport and a two-night stay in a SLH UK hotel.

## TOP LINKEDIN THREADS

- **Crowdfunding: the new funding phenomenon?**
- **Lean thinking: Special Report 38**
- **Do you know the cost of capital?**

**To join the debate look for ICAEW Finance & Management Faculty at linkedin.com**

## DOES YOUR FINANCE TEAM GET THE RECOGNITION IT DESERVES?


Can your organisation demonstrate an innovative and sustainable way of doing business that has had a positive long-term financial, environmental and social impact, underpinned by leadership from the finance function? If so, you should be entering the Finance for the Future Awards. We'll be looking for organisations to demonstrate how they have allocated financial capital effectively to minimise risk. Your entry should outline why the investment was worthwhile and how your approach has influenced strategy and decision making. To find out more about last year's winners and to apply online before 21 December 2012, please visit **www.financeforthefuture.co.uk**

## OFFICE HOLDER ELECTIONS

In July, four Finance & Management Faculty Committee members were asked to join ICAEW's new Business Committee. These members included faculty chair, Carolyn Bresh, deputy chair, Tony Powell, and committee member, Simon Jones. Their knowledge and experience will be invaluable as the new board is established.

Existing committee members were invited to stand to fill the vacated office holders' positions. An extra faculty committee meeting was held on 18 July to hold the elections. Dr Philip Smith, Rob Thompson and Jonathan Teller were unanimously elected to the positions of chair, deputy chair and vice chair respectively. Their term of office will run until the 2013 AGM. For more information on the current committee members and the new office holders see page 9.

## THE FUTURE OF FINANCE & MANAGEMENT

**We're looking for an experienced finance professional to be an ICAEW ambassador**

The Faculty's acting head Emma Riddell is leaving to study for an MA in creative writing. Emma has been a steady hand on the tiller since founding head Chris Jackson left for IFAC in New York last year. The Faculty team, and colleagues throughout ICAEW, thank her for her sterling service and wish her all the best.

With Emma setting out on a new path, there's an opening for a forward-thinking chartered accountant keen to continue her good work. We're looking for someone with great communication skills who's been on the frontline in a finance function. The role needs someone who can put themselves in members' shoes and translate the 'technical into practical'. They need a passion for the role of finance, insight into the art of management and belief in the importance of ICAEW as a source of influence as well as support for its members. Salary and benefits are competitive and the role will broaden your horizons. If you're interested please visit icaewjobs.com/job/21553/head-of-finance-and-management for more details and get in touch at **hrapplications@icaew.com**


**WOMEN IN FINANCE FLAGSHIP EVENT: HEADHUNTERS – REALISING YOUR DREAM JOB**
**CHARTERED ACCOUNTANTS' HALL, LONDON**
**19 September 2012, 17.30-20.00**
Trying to find the right job in today's competitive environment can be difficult. How can you increase your chances of landing your dream job? This event will feature a panel of leading headhunters from a variety of fields of expertise. There will be advice and helpful tips to drive your career forward, plus the opportunity to ask questions in smaller groups.
**Who should come?** Women in business.
**Why?** Assistance to find your ideal job position and networking opportunities.
***More information and online booking: icaew.com/wifseptevent***

**WORKING CAPITAL OPTIMISATION**
**ASSOCIATION OF CORPORATE TREASURERS, LONDON**
**20 September 2012, 08.30 – 17.00**
This one-day course is being hosted jointly with the Association of Corporate Treasurers. Richard Thornton FCA will present techniques that can help you manage working capital and permanently improve your cash flow.

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

This course involves practical exercises to apply the content to real solutions.
**Who should come?** Finance professionals involved with managing working capital for small and large organisations.
**Why?** Learn how to manage your working capital for improved profitability.
***More information and online booking: icaew.com/fmfactevent***

**FINANCIAL CONTROLLERS' CONFERENCE**
**CHARTERED ACCOUNTANTS' HALL**
**18 October 2012, 08.15-18.00**
Emma Riddell, acting head of the Finance and Management Faculty, will be joint chair of ICAEW's financial controllers' conference this October. The conference offers FCs a great opportunity to update their technical knowledge, get advice on strategic planning and decision making, and network. We'll be looking at the latest thinking around key disciplines such as cash management, credit control, technology and designing KPIs for the business. This is the perfect event for the FC in these uncertain economic times.
**Who should come?** All financial controllers, finance managers and finance professionals.
**Why?** Assistance to enhance your strategic planning and decision making processes as well as keeping abreast of the latest technical updates.
***More information and online booking: icaew.com/fcconference Members of the Finance & Management Faculty are entitled to a discount when booking.***

**COMMUNICATING IN A COMPLEX WORLD – STORYTELLING**
**CHARTERED ACCOUNTANTS' HALL, LONDON**
**25 October 2012, 08.30-10.00**
Today's CFO needs to communicate with impact. Many of us like to rely on linear ways of getting our point across: stating our opinion and then presenting the supporting evidence, but research shows that this is not as effective as you may think. Top rated speaker, Stephen Carver, Cranfield University School of Management, provides a practical guide to using storytelling in your business. What is it? How do you do it? What is the impact? Expect to leave with new ideas and a clear structure which will help you apply this technique in your business.
**Who should come?** Finance professionals who need to influence others.
**Why?** A new approach to communicating with impact.
***More information and online booking at icaew.com/fmfoctevent***

**CLARITY AND IMPACT FOR FINANCE PROFESSIONALS**
**CHARTERED INSURANCE INSTITUTE, LONDON**
**21 November 2012, 09.00-16.30**
Imagine writing documents that have clarity and impact, that people praise and envy, and that win new business or impress the board. Chartered accountant Jon Moon will help you transform your work, from notes and reports to information packs and slides, by focusing on five key elements: WiT (an alternative to bullet points that has three times the impact), graphs, tables, words and layout.
**Who should come?** All finance professionals who review or prepare financial information.
**Why?** Learn how to present information that has clarity and impact.
***More information and online booking at icaew.com/fmfclarityeventnov***

# It's Tuesday it must be Shanghai...

Against the tide of global recession, Asian markets offer a glimmer of opportunity. **Rick Payne** has some insider knowledge to help you find your way

Asia, and China in particular, offer both huge opportunities and huge challenges for our members. Like it or not, few of us can afford to ignore the impact that change in Asia is having, so I thought I would share a few thoughts raised by a recent trip to the region.

The growth story is well known – China is now the second largest economy in GDP terms with consistently high growth. Although there were concerns about slowing growth rates in China, some saw it as a smart move by the government to stop economic overheating and a hard landing.

Reports of a slowdown were not apparent on the surface. Hong Kong should have felt familiar, as I lived there between 1994 and 1996. But, on arrival, I was disoriented – the airport had opened after I left, huge bridges now link islands and land reclamation continues apace. In 20 years, Hong Kong island may be part of the mainland, making the Star Ferry a museum piece.

A taxi driver, always a good source of information, told me a new cruise terminal is being built, bullet trains will start running between Hong Kong and Shanghai in a few years' time and a bridge is under development to connect Hong Kong to Macau.

Change is rapid. If you are doing business in Asia or plan to do so you need to keep abreast of regulatory and capital market changes – these can both open and close doors. For example, the Chinese Yuan is slowly becoming a global currency. The competitive environment is also changing – some argue that local firms are becoming more competitive yet are increasingly favoured over foreign firms. A good source of information on the subject is the *European Business in China Position Paper 2011/12*, published by the European Chamber of Commerce in China available at euccc.com.cn/en/chamber-publications.

My trip covered Beijing, Shanghai, Guangzhou, Hong Kong, Kuala Lumpur and Singapore (or at least their seminar rooms, airports, hotels and taxis) and reminded me of the diversity in Asia. Even within China there are regional variations – so prepare carefully. Different regions in China may provide incentives for specific industries to set up there; corporate governance will feel familiar in Hong Kong and Malaysia but not in China.

One thing that seems common is the energy and commitment of people. The staff in our offices in Beijing, KL and Singapore dealt with emails at all hours, responded to last-minute changes to my programme and got things done in a day that would take a week elsewhere. The thirst for learning and knowledge, so apparent in the mid-1990s, seems even stronger.

In 20 years, Hong Kong island may be part of the mainland, making the Star Ferry a museum piece

So there was a keen interest in our research. But how do you communicate its nuances when translating the presentation? It was hard to gauge how my words were being received – high levels of interaction are rare in Asia.

Apart from the genuinely bi-lingual I suspect we will always struggle with the nuances of different cultures – but we need to make the effort if we want successful partnerships in Asia.

One topic mentioned repeatedly was the pressure put on CFOs by owners and CEOs to misreport financial information. Clearly this is a global issue, but there was a view that "in Asia it's different". I never quite got to the bottom of why. The greater importance attached to Guanxi (personalised networks of influence)? The belief that authority should not be challenged? Concerns about the rule of law and/or the greater personal risk attached to whistleblowing? Or other factors?

I am reading *China: A History* by John Kay and one paragraph seems relevant. "*Confucian tradition required ministers and advisers to be vigilant and to give voice to their misgivings, albeit in allusive language larded with respectful sentiments and laced with historical references… Whatever the risks – and they could be fatal – those charged with the role of remonstrance were expected to exercise it.*"

I have always been fascinated by Asia, so keeping an eye on change there comes easily. But I wonder if any of us can afford *not* to keep in touch with progress in the East.

**Rick Payne** is Head of the finance direction programme at the Finance & Management Faculty

FERIT KUYAS

# Meet the committee

The Finance & Management (F&M) faculty committee has three new members. We quizzed them, and their returning colleagues, for advice on facing the challenges of the year ahead.

## The new members

**BEN FREEMAN** is a consultant at Make Change Happen, working as an FD or change manager for clients. After KPMG, he set up systems and infrastructure in two fast-growing plcs, then took an FD role which led to an MBO. After a spell as divisional FD at Prudential's Property Fund Management arm, he moved into interim work with diverse organisations, from start-ups to the FTSE 100.

"Sometimes businesses aren't as effective as they like to think because issues have been ignored as 'too difficult'," he says.

"Businesses do not want a toothless FD," Freeman adds. "They want insight and balance. This goes against the grain for many FDs whose place in the team was won as the voice of caution. These are times when creativity and innovation are the key."

**TRISTAN PRICE FCA** is group FD at agricultural firm MP Evans Group, and a former OECD economist. "I have had a slightly different career – from Coopers & Lybrand to a privatisation agency in Germany and then a think-tank," he says. "My role now is pretty traditional as an FD in a smaller business. This means broad job scope and much variety," he explains. "You need more than the '7 hats' described in *Finance & Management*!"

He was attracted to the F&M committee because of the varied material it produces. "Output doesn't come out of nowhere – it's good to be involved in helping it happen," he says. "The niche for this faculty is clear: producing thought-provoking, well-written, stimulating articles for people in business. That's worthwhile."

**NICK WILDGOOSE FCA** is global supply chain product manager at Zurich Insurance Group. This role makes use of his accounting and other skill sets, being a fellow and former board member of the Chartered Institute of Purchasing and Supply (CIPS). "I moved from finance to set up the supply chain function at the Virgin Group", he says. "But now with increasing dependence on the supply chain and more outsourcing, FDs realise controlling third-party costs is key. And natural disasters like the earthquake in Japan also show how vital the risk management side of supply can be." With the supply chain becoming more crucial – Nick has also advised World Economic Forum in respect of supply chain risk. "Where there is a disruption the CFO and their team will be involved in sorting it out," he says.

## 1 Profession's big challenge

"The trend towards incomprehensible financial reports through ever more complicated and arcane rules-based standards."
**Paul Chan**

"Reputation. Credibility is tainted in the wake of the financial scandals and relevance is threatened with proliferation of accounting pronouncements that jeopardise judgement, brevity and business affinity."
**John Ferguson**

"Balancing the need for clarity in financial reporting against the cost and the potential for obscuring of ever more complex standards and detailed disclosure."
**Tristan Price**

"The constant value for money issue. Firms charge very high fees under extremely defensive engagement letters that undermines the advice given. Lawyers stand behind their advice much more readily than do accountants."
**Graeme Scott**

"Credibility and relevance – what do we do and why are we best placed to do it?"
**Rob Thompson**

**PROF BOB SCAPENS FCA**
Professor of Accounting and Finance, Manchester Business School.

"Keeping a distance from the criticisms facing bankers. There is a risk that people might ask where the auditors and accountants were when bankers were making such disastrous decisions."

"Keeping your pencil sharp – in other words, CPD in a changing environment."
**Len Jones**

"Accepting that accounts contain a high degree of subjective assessments that will change over time."

**DR PHILIP SMITH**
Turnaround specialist, visiting fellow at Cranfield School of Management.

## 2 Hated jargon

"All of it. I try to follow the Lucy Kellaway way."
**Tristan Price**

"The over-use of the word 'strategy' – for example, 'strategic marketing'."
**Graeme Scott**

"Waffle – focussed jargon can be useful."
**Philip Smith**

"The danger of any management or other jargon is that it can create barriers to understanding and common goals across an organisation. The finance function has a key role to ensure they communicate across an organisation in a way that everyone understands."
**Nick Wildgoose**

"Anything grammatically incorrect – such as, 'I need an explain for that number'. Verbs and nouns should be relatively simple concepts, even for accountants!"

ROB THOMPSON
Executive director at RBS International Banking.

## 3 A management tip

"Stretch your team. Stretching high performers goes without saying – but look also at your worst ones. Give them responsibility for a project outside their normal remit. You'll be surprised how people you'd previously thought were no-hopers can deliver results. *Caveat*: it doesn't always work – so don't bet the farm on it!"
**Paul Chan**

"Check alignment of resources against current and emerging needs. Can you do the challenging and important stuff rather than just the comfortable or urgent? Ensure agility and 'white space' to better respond to opportunities. It's important to safeguard against continuous stretch and stress of finance folk to avoid exhaustion or jumping ship."
**John Ferguson**

"Make sure the team's collective efforts are directed to the most important targets: ruthlessly pare down routine processes."
**Tristan Price**

"Be commercial: always check that an activity is adding value and being done as efficiently as possible. In short, what would you do if you owned the business you worked in?"
**Rob Thompson**

"Automate as much as is sensible."

JONATHAN TELLER
Owner of business intelligence consultancy Jtanalytics, former chairman of ICAEW IT Faculty.

"Ensure that everyone in the finance function adds value by providing advice and support to other managers."
**Bob Scapens**

"Link management and control function to operations."
**Philip Smith**

"Understand the make-up of your team, their strengths and weaknesses. Carrying out basic psychological tests can be fun and help with team building."
**Nick Wildgoose**

## 4 Lessons from the crisis

"Low gearing may be considered unadventurous, but it is very reassuring when a financial storm hits."
**Tristan Price**

"Be wary of macroeconomic forecasts – anyone who says they know better than you what the future holds is probably just guessing too."
**Rob Thompson**

"Be very careful about the performance measures and incentives used to motivate – especially senior managers. Do they encourage the behaviour we really want?"
**Bob Scapens**

"Guard against the herd mentality. Unconventional or counter-cyclical options must be taken seriously. As Warren Buffett wrote in 1984: 'Failing conventionally is the route to go; as a group, lemmings may have a rotten image, but no individual lemming has ever received bad press'."
**Paul Chan**

"I've stopped saying 'it's tough out there'. It's time to build on one's core skills and experience with creativity, flexible thinking and enthusiasm. As Covey would say in *The Seven Habits of Highly Effective People*, 'it is time to sharpen the saw'."
**Ben Freeman**

"Keep a focus on the basics."
**Judith Shackleton**

"Bad incentives and powerful leaders can massively corrupt

"Focus your team's efforts on what is important to the business."
**Judith Shackleton**

"Position all members slightly out of their comfort zone. This will give them the opportunity of better job security through broader experience – and for the more ambitious members it will create loyalty and real engagement. This will also smoke out the 'cruisers' within the team."
**Ben Freeman**

"Drive efficiencies through process improvements and allocating the right level of staff to the right tasks. Ensure all staff constantly evaluate how they can do their job better."

**GRAEME SCOTT**
Finance and Operations Director at Firstassist Legal Expenses.

**JOHN FERGUSON FCA**
Charity trustee.

"Keeping a sense of balance and calm – also among those he/she interacts with."

## 5 The FD's big issue

"Same as always: staying on top of it all..."
**Rob Thompson**

"Focus on working capital management and remember Cash is King."
**Helen C Stevens**

"Planning in an ever-changing environment."
**Judith Shackleton**

"Cash: establishing projected cash balances within a reasonable likelihood and finding sources of funding to cover any gaps."
**Tristan Price**

"Driving efficiencies – doing more with less – throughout the business."
**Graeme Scott**

"Ensuring that actions they support are really driving shareholder value and that relevant risks are appropriately evaluated."
**Nick Wildgoose**

## 6 A saying to manage by

'Aut non tentaris, aut perfice.' *Ovid*
*(Either do not attempt or else achieve)*

"Do the right things, then do things right – get your strategy right to be effective, then drive efficiency."
**John Ferguson**

"Get the most 'bang for your buck' from everything you do."
**Graeme Scott**

"Resources, to produce results, must be allocated to opportunities rather than problems." (Peter Drucker, *Managing for Results*.)
**Paul Chan**

"Play to your strengths."
**Bob Scapens**

"The future is uncertain."
**Philip Smith**

"Begin with the end in mind." (Stephen Covey, *The Seven Habits of Highly Effective People*.)
**Judith Shackleton**

"Keep it simple."
**Rob Thompson**

**HELEN C STEVENS ACA, MBA**
Portfolio of NED/chair roles: Showcase Communications, Style-passport, INSEAD Alumni Association; business angel and mentor to entrepreneurs.

"Cash is king."
**Jonathan Teller**

"When the going gets tough, the tough get going. Where there's a will, there's a way."
**Ben Freeman**

"Avoid being 'full of sound and fury, signifying nothing.'"
**Tristan Price**

"Follow the money."
**Len Jones**

"Put the customer at the centre of what you do."
**Nick Wildgoose**

"Communicate, communicate, communicate – strong and ongoing communication is so vital."

**MICHAELA TALBOT**
Finance and Operations Director of Specialty Catalog Corporation UK subsidiary.

an organisation and sector – it's not new, but happening on a broader scale now. I'm reading Anthony Sampson's 1981 book *The Moneylenders* and it is quite scary to come across examples of 'unacceptable faces of capitalism' and avarice that recur generations later."
**John Ferguson**

"Effective working capital management continues to be a key differentiator."
**Helen C Stevens**

**PAUL CHAN**
Finance and change consultant.

"That we stifle SMEs by subsidising or supporting large companies."

## 7 Concern in 2013?

"Finding the right way to identify and keep the strongest members of staff."
**Tristan Price**

"The slow disintegration of the Euro… if it survives 2012!"
**Graeme Scott**

"Keeping the brakes on – excessive emphasis on cost containment while losing the art of how to spend wisely for value. Also, the failure of government to appreciate the structural changes of globalisation and offshoring, allied with myopic, London-centric attitude that fails to address countrywide economic issues."
**John Ferguson**

"Too much austerity, too little growth."
**Bob Scapens**

"Uncertainty about the future slowing down decision making."
**Judith Shackleton**

"That the general pessimistic outlook could become a self-filling prophecy."
**Jonathan Teller**

"There is only one thing worse that the Euro imploding: yet another year of putting off the moment of truth, of uncertainty and doubt."
**Ben Freeman**

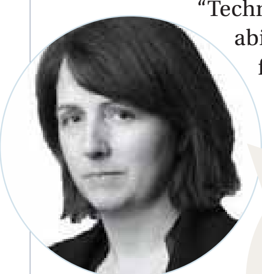
"Cost-cutting is a necessity – but not to the extent that the potential growth of the business, and ability to respond to opportunities, is stifled – there is a balance to be reached."
**Michaela Talbot**

## 8 Biggest opportunity in 2013?

"Thriving on chaos – sensing and seizing openings backed up by competitive intelligence and an adequate balance sheet."
**John Ferguson**

"Laying good strategic foundations for the next upswing, and building on them. The potential for growth, and results, in five years' time is being determined now."
**Tristan Price**

"Technology and its ability to change all facets of business."
**Graeme Scott**



**JUDITH SHACKLETON FCA**
FD for TelecityGroup.

"Staying agile to ensure your business is able to respond to market changes quickly."

"Look to the future. The crisis will come to an end – and those who are well prepared will be able to take advantage."
**Bob Scapens**

"Between 50% and 80% of business costs relate to the supply chain. There are significant opportunities for the finance function to better manage this."
**Nick Wildgoose**

"Many expect the economic recovery to be slow, so businesses need to keep working towards their medium and longer-term goals and position the business to take opportunities."
**Michaela Talbot**

"Sticking to the core competencies."
**Len Jones**

"Develop and use social media to its full extent, as a very cost effective way to grow businesses and maximise personal visibility."
**Helen C Stevens**

## + The Faculty

### HOW SHOULD MEMBERS GET MORE INVOLVED?

"Ask the faculty to address a topic that concerns you."
**Paul Chan**

"Come to faculty seminars and comment about what you liked or disliked. Lobby the faculty with topics you want to see covered."
**Tristan Price**

"Make better use of the community, either through LinkedIn or blogs."
**Graeme Scott**

### WHY SHOULD PEOPLE JOIN?

"To get access to new ideas and perspectives."
**Paul Chan**

"It's an excellent way to stay up-to-date with current best practice thoughts."
**Jonathan Teller**

"They get to meet people like me!"

**LEN JONES**
FD at Practical Car and Van Rental and SME committee member at the Auditing Practices Board.

"To keep up to date on finance and management matters and gain useful insights from other sectors."
**John Ferguson**

"It demonstrates and facilitates your commitment to updating financial management skills and knowledge."
**Philip Smith**

"It puts a wealth of knowledge and viewpoints at your fingertips – which often help challenge your own thinking and approach."
**Michaela Talbot**

"It provokes you to think."
**Tristan Price**

"Great value CPD."
**Graeme Scott**

CORBIS

# Tightening the chain on fraud

Procurement fraud has a far lower profile than more headline-worthy varieties – but it provides rich pickings for its perpetrators. How can businesses prevent it? **Paul Guile** has some advice

Procurement fraud is nothing new. Samuel Pepys mentions kick-backs in his diary from the 17th century. In the 21st century, it has the dubious distinction of being one of the highest-risk forms of commercial fraud. Unfortunately, it's also low visibility.

It may not grab the headlines like embezzlement or securities fraud. But with both a huge number and value of transactions, procurement is a natural target for fraudsters.

The National Fraud Authority's most recent survey, published in March, reports that procurement fraud cost the UK public sector about £2.3bn in 2011 – that's nearly 1% of the entire government procurement budget. And in a CIPS (Chartered Institute of Purchasing & Supply) online survey, 9.3% of businesses confirmed that they had suffered at least one procurement fraud during the past year.

While preventative measures are taken against other types of fraud, procurement fraud is considered a problem only after it has occurred

And while preventative measures are taken against other types of fraud risk – usually ones that have more obvious reputational consequences – procurement fraud appears to be considered a problem only after it has occurred. Fortunately, there are some relatively straightforward steps that can be taken to combat it.

### COMMON MISTAKES

The first step towards tackling fraud is to stop making the kind of common mistakes that we've documented over the years, including the following:

- Procurement does not have the importance it should. Operations or sales departments gain kudos for generating company revenues, but most of that money is spent in procurement. Yet many organisations do not have procurement visibility at board level. Some don't even employ procurement specialists.
- There is no procurement fraud strategy. If fraud risks are considered at all, they are not linked to procurement. Yet both of these issues are based on the value for money approach and are therefore natural partners.
- There's been no procurement fraud training – in some cases, it's never even been considered. How can people spot procurement fraud if they are unaware of how it can be committed?

### THE RISKS

As is the case with any mitigation exercise, a decision has to be made on whether to treat, transfer, tolerate or terminate the risks, which can be immense both pre- and post-contract award.

To combat the risks pre-award, ensure the tender evaluation board and procurement teams are trained to identify both the procurement fraud risks and, in particular, bid-rigging. If there's any doubt, they should check. It doesn't matter if they are wrong. And they might save millions if they're right.

But as a rule of thumb, risks tend to be greater post-award. Why? This is when the money that's been allocated is actually spent; the end user may not be fraud aware; there is a focus on service delivery not fraud prevention; and there is more time for fraudsters to work where your company process weaknesses are.

Procurement does not have the importance it should have within organisations

Additionally, the contract is open to abuse through variations, maintenance, ad hoc works, inflated invoice prices or bogus consultancy works. (The full list of potential abuses is vast.) Often it's a third party managing and implementing the contract, so there's a new entity to consider. And if fraud controls exist at all, they tend to be weaker post-award.

This is especially true in projects that are often fluid in their delivery and subject to variations and design changes. Contracts that are being fulfilled in remote areas are particularly vulnerable to fraud because staff monitoring is harder and controls are less thoroughly applied away from the main organisational hub.

Another area of risk relates to subcontractors. As the commissioning organisation, you may not know them at all even if there is a requirement for them to be disclosed during a tender.

### CASE STUDY Weak links in the supply chain

*Some details in this case study have been changed to protect the organisation but the story is true.*

Large European project company VictimCo, which had an annual turnover of hundreds of millions of pounds, had various fraud policies in place. But owing to its size and complexity these policies were not implemented and enforced across the whole organisation.

A senior project manager, Peter, was reported to have close relations with one of its suppliers, RipCo. But as no other information was forthcoming this information was initially dismissed as irrelevant.

When the spend for that supplier was checked, it was found to represent a very substantial proportion of the total contract for which Peter was responsible. The value of works awarded should have been tendered but each of the works packages had been separated so that each one dropped below the tender threshold. But although anomalies had already been noted by the company, delivery appeared to be going smoothly so the fraud risks had been ignored.

It transpired that Peter had been raising, signing off and processing purchase orders with a substantial budget. If this was queried by procurement staff – Peter's own temporary appointees to the project – they were removed and someone more cooperative was appointed in their place. So any suspicions remained unreported to both the compliance department and the FD for the area.

Eventually VictimCo discovered that the initial tender process for the supplier, made some years earlier, had been manipulated. The fraud had been planned and orchestrated for some time but the parties involved had been patient and let the fraud gradually develop.

The final loss was estimated to be millions of pounds. But the company declined to prosecute owing to the potentially huge reputational damage. The money was never recovered.

CORBIS

## Ensure the board understands the importance of procurement and the risk of fraud across its life cycle

Robust auditing of subcontractors will help mitigate this risk. Where project manager and contractor have to work together for successful delivery, there is also a risk of corruption through collaboration.

### MITIGATION

So how do you mitigate these risks? While some of the controls are the same as for bribery and corruption there are additional points to consider.

- Ensure that the board understands the importance of procurement and, crucially, the risk of fraud across the procurement life cycle.
- Advertise your organisation's fraud strategy and supporting policies, including whistle-blowing, to staff and contractors. It might put off fraudsters.
- Use a conflicts of interest policy and ensure that declarations are checked – ask staff to sign up during their appraisals, for example.
- Draw up a policy for gifts and hospitality, including defined financial thresholds. All offers of hospitality should be recorded, whether they are accepted or declined. This information ensures your compliance, audit or fraud department will be aware if a contractor is trying to target your organisation through multiple offers of hospitality.
- Due diligence on suppliers is key. Contractors are usually given advance warning of an audit so consider giving no notice to see what is really going on.
- Consider setting a procurement breach process – exception reporting of anyone who fails to follow procedure. As well as drawing attention to potential fraud, it might also identify other commercial weaknesses – for example, whether staff understand your policy or not or the policy itself is inadequate.
- Check for potential conflicts of interest by comparing data on your staff with those of your suppliers.
- Initiate a two-person change process so that one person cannot add or delete suppliers on your system nor change bank account details.
- Clear the company's system of any old or dormant suppliers. After a year of inactivity consider removing that supplier – if you start to trade with the business again, re-qualify it.
- Variations are often used as a method of hiding fraudulent losses. Set a maximum limit that the contract can be varied. If it exceeds that amount, then ensure this is reviewed by a variations board.
- Watch staff movements during or after a tender award. If a member of your staff moves to work for a supplier immediately after a tender, treat that supplier as high risk: information may have been passed in return for a job offer. The US government has addressed this risk in the Procurement Integrity Act.

FDs and financial controllers can start by ensuring procurement risk is raised at the highest level of the organisation (ideally the board) and that suitable training, prevention and detection measures are in place. In lean times, when organisations are looking for every penny to go to the bottom line, this is a risk area you can't afford to ignore.

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# SUPPORTING ROLE

For **Simon Fuller**, finance director of retail operations for Tesco, creating an optimised finance department is about supporting staff, customers and shareholder interests alike. In this final interview in the three-part series he tells Adrian Holliday about his strategy

**What steps have you taken to optimise Tesco's finance department?**

For me it's about three key things. The first is supporting the development of people and ensuring that as a leader in the business I help people do the right things for their internal stakeholders and, most importantly, our external customers and shareholders. So the team all have the opportunity to develop in their jobs and progress into bigger and more influential roles. I've been in Tesco for almost four years now and one of my proudest achievements is seeing people move on to have a big impact in other parts of the business.

Secondly, ensuring finance has a voice in the organisation – and ensuring it has credibility. It's not just about keeping the score – it's understanding the business at the shopfloor. It's about spending time out in shops and depots with staff and customers and living, breathing the operation. This type of experience makes us much more effective business partners.

Thirdly, I'd say, it's about cross-functionality. Finance uniquely touches all areas of the business so we have an opportunity to leverage that strength. I consider an important part of my role is to enable my team to work effectively across all areas of the business. This is what really unlocks value.

**How about overcoming complexity? What is your programme for streamlining the workings of a large retail business?**

Much of life's complexity is self-created. So my way of approaching challenges is to try to boil them down to their simplest building blocks. I frequently urge my team to condense the things we do into a few bullet points. There are very few problems that can't be summarised in this big picture way.

In practice, working in a large business also often means looking for themes. For example, this year Tesco has a programme to refresh many hundreds of stores in the UK. When looking at the performance of these refitted stores we need to draw broad-based, as well as individual store, conclusions. So we may have all the data we need at a micro level, but we also want to look at things in a macro way: what have we learned? What works best? What do our customers like?

My job, at its core, is not just about controlling costs; it's about working with the business to best balance our cost base with the customer service we offer. It's about making sure we use our money optimally to give our customers the best shopping trip we possibly can.

**Given Tesco is the UK market leader, how does it maintain its focus on customers?**

The UK grocery market is fiercely competitive, which is great for customers. In this context, Tesco takes its position as the market leader seriously. What we need to do is be the leader in the industry for doing the right thing for our customers. And when we do the right things for our customers then we do the right things for our shareholders.

This is really the focus of our recently launched "Building a better Tesco" strategy – making things better for our customers, staff and ultimately shareholders. Not any one of these to the exclusion of the others.

As part of this six-step strategy, we're investing about £200m into our stores – enabling more staff hours particularly in large stores and particularly in fresh food. This is what our customers want and therefore it is a central part of this year's business plan.

**How would you describe the optimal finance department?**

As part of the wider UK finance organisation we have a slogan of being *More than just a finance team*. Prince Charles, I think, said in an article recently that accountants should, "count what counts and measure what matters". I agree these are vital roles.

Also, building on this, a truly optimal finance department leads the business and helps it to make better decisions through coaching and supplying insight. There needs to be a strong base of financial control. We talk a lot about that. We can't move onto leading unless we have a strong financial bedrock.

**How can the finance department support the model of a continually expanding organisation?**

Primarily it's about flexibility. It's about being clear on the priorities of the business and aligning to them. It's important too that we help the business to strike the right balance between moving into new areas and maintaining a focus on the core of what we do.

Being connected is an important role for the finance team to help optimise the use of resources – it's important to invest in new areas, but be conscious of returns and know where our priority areas lie and where investment will have the biggest impact. Underpinning all of this, finance needs to have an independent voice, driven more by facts than emotions.

# Making the leap to leader

A first-class manager does not automatically become a great leader. **Dr Mark Pegg** explains what it takes to make that transition

So you want to be a leader? Or perhaps "they" want you to be a leader? There is a world shortage of leaders, particularly good ones, and taking on the role is an important, usually life-changing decision. Good leaders give clear direction, build morale and help their organisations succeed. Is this you? How can you be sure?

Some leaders are born but, keep the faith, many more are made (see case study, right). If that role is for you, let's explore what might help you to make a smooth and successful transition to leader, the key competencies you need to become an effective leader, what to avoid and how you can plan a path that works for you.

## FINANCE MANAGEMENT ROUTE

The evidence is that many CFOs go on to become CEOs. Progress in the finance function offers a clear path to the top.

At one time this was the principal route to the top, but research by Standard & Poor's suggests that today finance (20%) has been overtaken by operations (30%) as the most popular functional role prior to becoming CEO. Marketing comes in at third place at 10%.

It may be that the path to becoming CFO is your current career goal. If so, you'll find that there is more opportunity than ever for finance professionals to acquire and practise their leadership skills. As organisations become flatter, they are requiring more empowered leaders at every level of their core finance function.

## WHAT DO YOU NEED TO LEAD?

Most professionals want to get on, but many are happier doing pure finance rather than leading and are often unsure whether the leap to leader is a price worth paying. In acquiring a professional qualification, you have demonstrated that you have ability and you probably know the essentials of the business very well indeed because you have to report and monitor it so closely.

But you may like doing the day job too much and find it hard to give up the love of detail and the attachment to certainty and precision. To be the best you can be in the finance function is admirable but if

REX FEATURES

> Some leaders are born but, keep the faith, many more are made... Be optimistic about the changes you can make

you're planning on being a leader ask yourself whether building relationships is your strong suit. Is emotional intelligence something you can acquire? Will you feel comfortable in a world of ambiguity? Can you bring people with you, spend time with them, connect with them, build a psychological contract?

There are no rules that say when you are ready to lead and no age limit either. There is more than one way of leading. No one size fits all. The path to leading is rarely smooth; it often comes in sudden bursts and you are tested in crises as your career progresses. It's said that while you can teach management, leadership is something you have to learn.

Experience is vital. Inevitably, some people should never become leaders and should stick to the day job. Better decide now rather than later.

## GETTING STARTED

As your starting point, assume that pretty much anyone can become a better leader by learning how to practise a set of professional skills and behaviours. They must also acquire the confidence to leave a career as a successful finance manager and make the leap to powerful leader.

You do not need to be another Nelson Mandela or Winston Churchill to be a good leader. Some of the behaviours that help make you successful in finance – determination and resilience, for example – will also help you as a leader. But some behaviours need to be left behind and new ones acquired.

It's important not to continue tinkering with the old job when you should be letting go of it to get on with the new one. If you are still working the numbers, strengthening the skills you are already good at, then the chances are you are not

## CASE STUDY

**Bren Hutchinson (below), director of finance at the UK's second largest ports group, Peel Ports, describes her own transition from manager to leader.**

"I was known as being technically very capable, but wasn't great at bringing people with me. My promotion prospects were halted as I was too focused on getting it technically right – my interpersonal skills let me down.

"I've learned from my mistakes and, vitally, by observing the behaviour of others, both good and bad. My then boss helped by sending me on a Dale Carnegie influencing course. My eyes were opened. I needed to be the person who has technical knowledge plus the ability to express ideas to assume leadership and to arouse enthusiasm.

"Yet I still didn't delegate or trust people enough – much to my current CEO's frustration. He wanted more, he believed in me and put me in the acting CFO role – so I simply had to let go as there wasn't time to keep doing my old job. My contribution was now needed and valued as part of the senior team's decision making.

"The CEO also sent me on a leadership programme. I am learning from expert executive coaching how important it is to:

- think with passion not emotion, not seeing criticism as a personal attack but as an opportunity to get the best result;
- put myself in the other person's shoes; and
- give autonomy in process (not in ends) if you want to get the best out of people.

Previously I wanted to know the detail and monitored things too closely. My managers felt I didn't trust them, which isn't the case. I backed off, trusting them to keep me updated, and we now hold catch-up meetings so I keep in touch without taking away freedom.

"The important lessons I've learned in the leap to leader have come by recognising and addressing my interpersonal weaknesses. I've learned I can't always control what happens to me but my response is entirely within my control. Previously, when I received an inflammatory email, I used to seethe, blame the sender for my mood and wait 24 hours to reply. Now I take a deep breath, take ownership of my mood and watch it dissipate. This has been transformational."

paying attention to the skills that now need developing.

Consider the different levels of your organisation: are you over-led and under-managed or under-led and over-managed? What are the visible signs of this where you work?

The ability to delegate, to see the wider context around the detail, the value as well as the price, becomes more important. Soft people skills such as influencing, communicating and motivating are the hardest to acquire.

Think about your experience so far in finance. Why should anyone in your office be led by you? How do you relate to others in the finance team? Could you have done a better job leading the last project? Have you made sense of complex and ambiguous situations where there do not seem to be any right answers?

## FROM MANAGER TO LEADER

Analyse how you will make the transition to being a leader. Look at the differences in management and leadership behaviours to identify the leap you need to take. The graphic below sets out differences between the facets needed in management (grey) and those required in leadership (green).

What does this mean in practice and how can you build this into your plans to make the leap to leader? I surveyed one organisation, asking emerging leaders what they liked and disliked about those who led them. Among the positive attributes cited were integrity, honesty, a can-do attitude and a keen sense of team working. They cited their main dislikes as lack of feedback and communication to the team and poor attention to training and support.

These findings suggest some of the areas that need attention if you are to develop into the sort of leader needed for the 21st century. Traditional thinking needs upgrading. The idea that leadership involves lots of charisma, leading from the top down and imposing order on the world has largely been replaced. The world of command and control is over. People want freedom and if they don't get it they won't stay with you.

Today's successful leaders motivate and connect teams of skilled professionals to deal with a rapidly changing, complex world. This involves a different mindset, a different view of leadership. If you as a leader develop your people, your people will develop your business. Success is not just about leaders at the top but leaders at every level.

Leadership specialist George Binney describes modern leadership as a social process. It happens in incidents and moments between leaders and followers. It is dynamic and changing. You have chosen leadership; you have chosen to speak for others. This is like being on stage, with the benefits and inconveniences that entails. People will make you a hero and a villain, give you applause and throw rotten tomatoes.

Lofty remoteness is a thing of the past. You have to be in the middle of things and overlooking things to sense what will work. You are at your most effective when you are leading. This is not the same as being yourself – when you lead you are on a stage. It's not about being perfect either – what makes people interesting is their imperfections. Find the right leadership style for you and forget a fixed template – instead find the approach that works best in your context.

Get connected. Building your emotional intelligence is vital, so show openness and trust, earn respect, deal with conflict, think together on real issues, encourage shared values and perspective, connect with individuals and groups.

## MAKING A DIFFERENCE

As a leader you must have a cutting edge. Leadership in business is not just about improvement; it's also about winning. If you only bring about improvement you still may not survive but if you can produce better leaders than your competitors you are more likely to succeed.

In making the leap to leader you need to be clear on what you want to achieve. It will be disappointing if getting to the top is the end itself. Some leaders are in name only; they are in office but not in power. You have real opportunities to make your mark by taking responsibility and solving problems.

Aim to be a leader with the pride, pace, passion and professionalism to do the job well. If you can't get passionate about success in business, innovating and inspiring others, creating a sustainable business that cares about people and the planet we live in, then what can you get passionate about?


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# HOW TO BE A LEADER

## AVOIDING DERAILMENT

Your plan to become a leader should also consider what not to do – shaping the choices in your working life to address some of the common mistakes people make. A research project at the Center for Creative Leadership tracks leaders globally and identifies persistent themes over the past three decades among managers who had high potential for success. It looks at the reasons they either made the transition from manager well or fell short and derailed.

**Why some leaders managed the transition from manager well:**

- more diversity of experience in their track record – they tried more things;
- did different things well – they were adaptable;
- maintained composure under stress;
- handled mistakes with poise and grace – and learned from them;
- focused on problems – and solved them;
- got along with all kinds of people.

**Why some were derailed:**

- problems with interpersonal relationships;
- failure to meet business objectives;
- inability to build and lead a team;
- inability to change or adapt during transitions from manager to middle manager and then leader.

SOURCE: CENTER FOR CREATIVE LEADERSHIP

## GAINING EXPERIENCE

If leaders develop through experience, how do you get the experience? A good way is to get involved in your local community. You may be busy getting the day job done and need time for the family but some involvement rarely fails to repay your time. You will be part of the Big Society – most schools, social enterprises, sports clubs, Scouts and Guides need people with financial skills – but treat this as an opportunity to focus on leadership too. Develop your leadership skills and observe leaders in action too. Offer to chair a meeting or to lead a committee. Become chair of the governors: can you lead them, can you bring a diverse group of people with you and influence their collective decisions?

## FIVE TIPS FOR DEVELOPING LEADERSHIP

1. **Treat the path to leader as a journey** It should be a path of self-discovery, developing your skills to make the leap to leader. Why not start your journey today?

2. **Learn from experience** Look at where you have come from. Past lessons are valuable – we learn more from our mistakes than from when things went well. Keep looking for opportunities to learn more about being a leader. In leadership research we often ask, “If I knew then what I know now what would I do differently?”.

3. **Know yourself** Raise your self-awareness – how do you have an impact on others? How resilient are you? How can you find the right style for yourself? Gather as much data as possible on your psychological profile. Get feedback and ask yourself, “Why should anyone be led by me?”.

4. **Know your context** How do you lead with people in your own reality, not what it says in the leadership books? How do you relate to others and to your team? Treat problems as opportunities; practise your skills as a leader, influencing, coaching, motivating, dealing with performance, attending to the virtual world.

5. **Build a vision** Set out your manifesto – describe what you want to be as a leader in order to connect and communicate with your followers.

## THE LEAP TO LEADER: A FIVE-POINT PERSONAL DEVELOPMENT ACTION PLAN

**1. Prepare to invest in yourself**

Adjust your mindset – you have to find time to learn how to be a better leader.

**2. Be optimistic about changes you can make**

Apply the 60:30:10 rule – 60% reacting to events: 30% bureaucracy: 10% moving the organisation forward. This means a 2% shift in your effort has a big impact on that small 10% part of your day job and can give you a 20% improvement in your effectiveness as a manager.

**3. Get feedback**

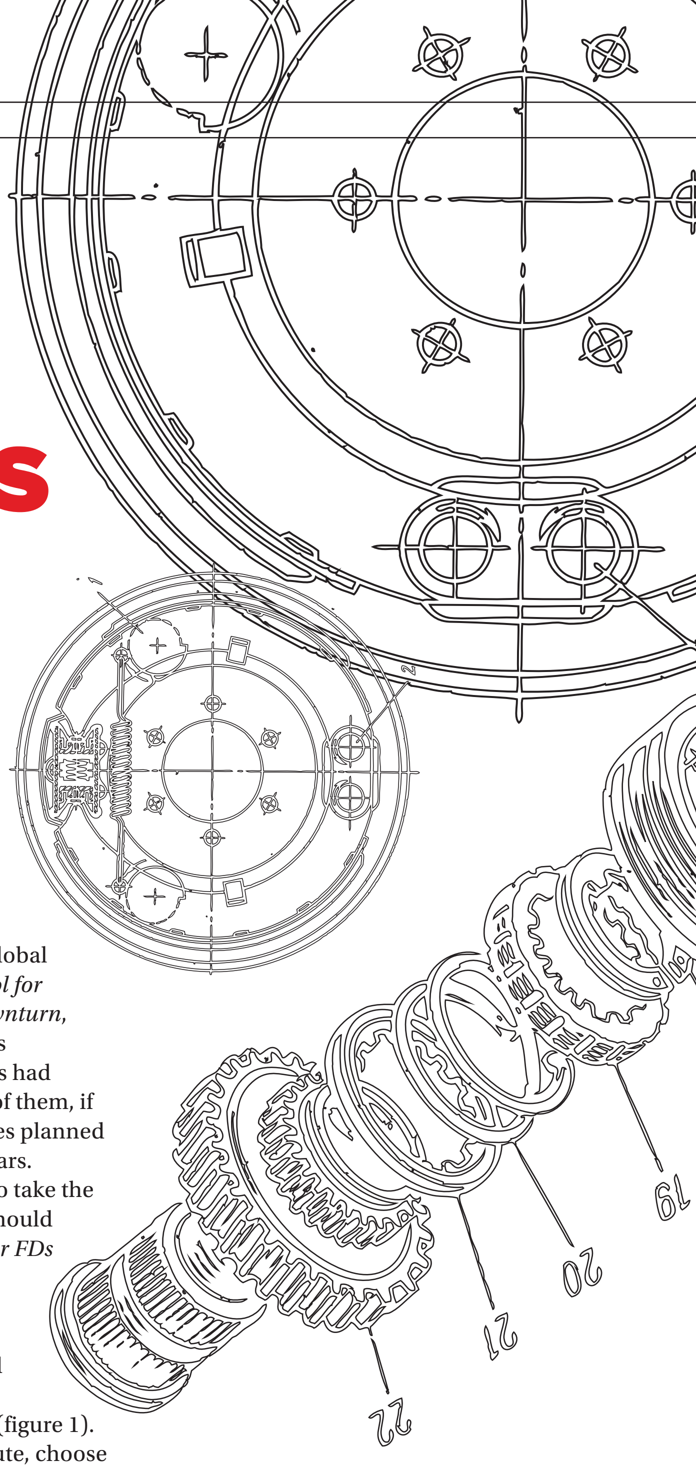
- Identify your development needs.
- Don’t forget your strengths – you can still work on those too.
- Think what you might do less of and what you need to do more of.

**4. Be honest**

- Set short-term SMART objectives (specific, measurable, achievable, realistic, timed).
- Set longer term complex objectives using a force field analysis – what are the forces that support your objective? What are the forces that are holding you back?
- For each supporting force, what can you do to strengthen that force? For example, if you like taking on new projects how can you make sure your name goes forward when new ones are being considered? Develop SMART actions. Speak to your line managers, raise this in your review, actively volunteer.
- For each force holding you back, what can you do to weaken that force? For example, if you have too little to say at team meetings and find it difficult to make an impression, develop SMART actions. Plan interventions, rehearse what you might say before the meeting, make some small interventions initially and achieve some early wins.

**5. Review progress regularly**

- What development needs do you have?
- What actions have you taken?
- Keep under review.



# THE HOW-TO GUIDE TO... JOINT VENTURES

In the first in an occasional series on setting up new business associations, **Chris Stott** explores the essence of a successful joint venture

A joint venture – or JV – is a business agreement where parties agree, for a finite time, to contribute assets and equity to develop a new entity. They exercise control over the enterprise, sharing revenues, expenses and assets.

Compare Morecambe and Wise with Blair and Brown and it's clear that some partnerships shine while others flounder.

JVs are likely to proliferate in the coming months, so how do you set the stage for yours to be a class act rather than an association characterised by discord and bitterness?

> Morecambe and Wise, Blair and Brown: some partnerships shine while others flounder

Beyond the basic definition, a JV allows an organisation to complement organic growth through access to new markets without having to provide funds for an outright acquisition.

A JV offers the chance to dip a toe in the water, an alternative way to grow and obtain knowledge that would be costly or time-consuming to achieve alone.

Such an alliance demands cooperation and trust, often designed to share risk. While world economies remain uncertain, joint ventures should have special appeal to executives across the globe. As such, they are likely to prove a popular approach to achieving growth.

In a recent KPMG survey of global companies, *Joint ventures: a tool for growth during an economic downturn*, more than 50% of the executives questioned felt that previous JVs had delivered everything expected of them, if not more. And 50% of companies planned to pursue JVs in the next two years.

For those that have decided to take the JV route, some essential rules should be observed (see our *Top tips for FDs planning a JV*, right):

The whole venture should be thought through from the start: pre-decision-making; entry and setup; JV implementation and operation; and the parties' exit (figure 1).

Once committed to the JV route, choose the right partner. To achieve this, you must focus on candidates that:

- show proven competency – M&A track record, professionalism;
- are stable – balance sheet strength, liquidity, regulatory track record;
- have credibility in the marketplace – knowhow, reputation;
- complement your business – including cultural fit; and
- fit the objectives of the intended alliance.

This involves trust and goodwill, qualities that can be difficult to maintain in uncertain times but are essential for working towards collective success.

## AGREE A ROBUST PRE-NUPTIAL

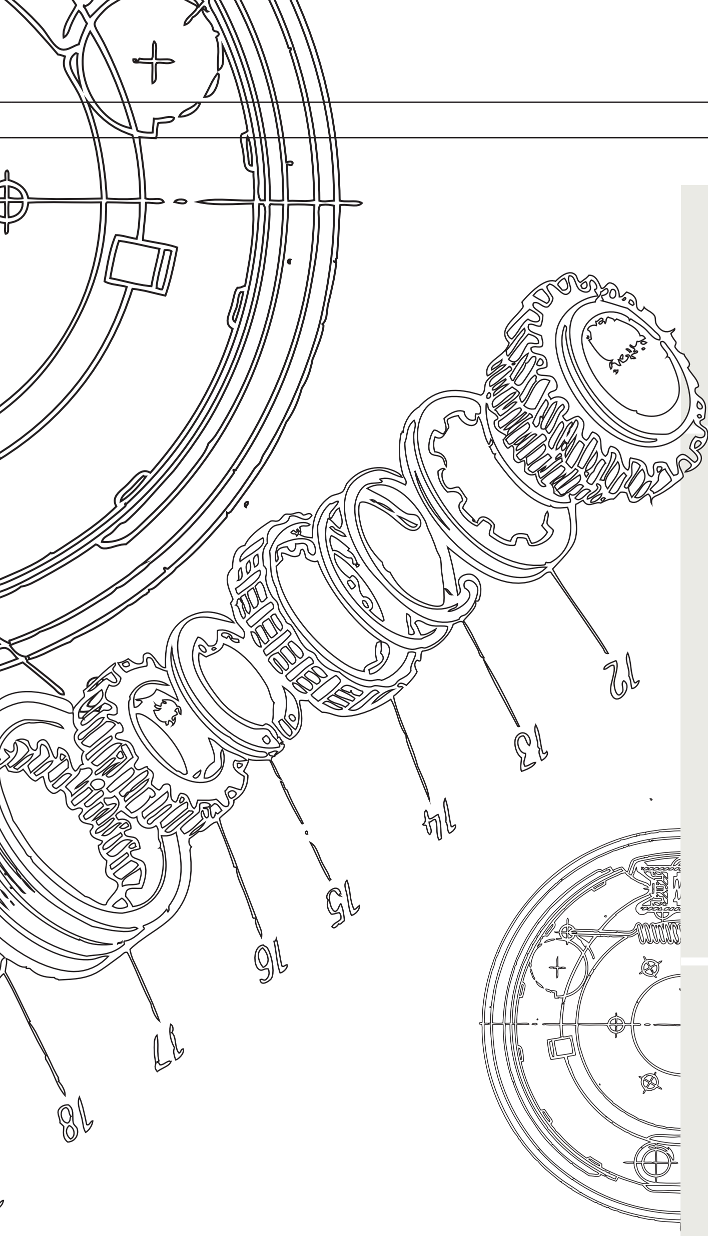
Ensure you agree things in minute detail. JVs are in some respects trickier than acquisitive transactions because there is a buy and a sell happening on both sides. There should be a robust pre-nuptial agreement so both parties have their interests aligned. You should agree on objectives such as:

- how profits will be distributed – either fixed (50:50 profit share, for example), fixed fee or performance based;
- operational responsibilities; and
- how to separate when the agreement ends – share costs of winding the JV down, option to buy-out the other party through agreed price mechanism and so on.

The strategic imperative must stack-up and the JV must be more than the sum of its parts, recognising that both parties wish to add value for themselves.

## GIVE IT YOUR FULL ATTENTION

JVs should be treated as a full acquisition in focus and planning. They require less upfront cash, but are still risky given the




multiple possible causes of failure – from cultural problems to delivery failure and problems extracting and accounting for value. Both parties must be 100% dedicated to achieving the expected objectives. Trust can be backed up by due diligence. It is a good idea to use independent corroboration to sense-check objectives, deliverables and contracts. Analyse a JV partner's ability to deliver against the terms of the agreement. This would normally include financial, tax and legal experts together with commercial and strategic input (see case study, right).

## CONCLUSION

Joint ventures are undoubtedly a complex undertaking. Yet their frequently lower upfront premiums put them at a considerable advantage from day one, making them worth exploring.

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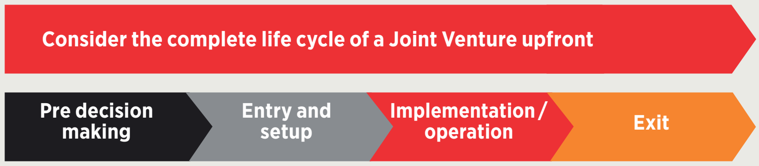
**FIGURE 1**




## WILL A JV WORK FOR US?

With liquidity evaporating in global markets, JVs are increasingly seen as strategic tools for growth. They are not restricted to a particular sector or company size and can work for:

- multinational corporates;
- small businesses that believe partnering will help them successfully fight their bigger competitors;
- large corporates forming JVs with smaller businesses to acquire critical intellectual property, technology or other scarce resources; and
- a mixture of public and private sector organisations.

In recent years, there have been several high-profile JVs in the automotive sector, and in the oil and gas sectors as companies looked further afield to develop and gain access to reserves.

The climate of austerity means public/private JVs are also more common, as are JVs in emerging economies, giving UK businesses access to new markets in fast-growing overseas economies.

## TOP TIPS FOR FDs PLANNING A JV

- Make sure your business is prepared – conduct SWOT analysis, consultations with employees, make business plans, cashflow plans and projections.
- Choose the right partner – ensure the culture of a proposed partner fits with yours, and it has sound finances.
- Agree who is investing what and how – sources of funding, how to guarantee borrowings, how profits, losses or capital gains will be divided.
- Ensure the joint venture agreement covers issues such as business objectives, financial arrangements, how the business will be run, how intellectual property will be protected, what a dispute resolution process will look like, how the two businesses and their teams will communicate, which business is responsible for what, and the legal structure of the joint venture.
- Agreements must outline the procedure for terminating the agreement, in addition to who owns which assets and any liabilities resulting from the joint venture.

## CASE STUDY: DUE DILIGENCE

Multinational energy company (X) considered a production sharing agreement with Y, an oil exploration entity in central Asia. X would also provide financing to Y.

To test its commercial viability, X needed details about the JV's operation. X worried about reputation risk should Y be associated with unethical activities under the Foreign Corrupt Practices Act. It also worried about non-compliance with European legislation should serving public officials be hidden beneficiaries.

Due diligence confirmed that there were no major allegations or suspicions concerning the award of the exploration assets.

Due diligence also identified anomalies in the corporate structure of Y that created possible legal risks for X. X used the information to negotiate a clearer legal position.

An integrity due diligence investigation was conducted into the background, track record, reputation and perceived integrity of the individual owning Y.

With the information the checks provided X was able to move ahead with the proposed business relationship.

ALAMY

# "Where's my jet-pack?"

Business technology was born in the finance function – and accountants make more use of it than most. So why hasn't IT completely revolutionised the role of finance? And how might accountants engage with it to engineer really radical change in the future? **Kirstin Gillon** investigates

Finance functions have frequently been at the forefront of new developments in IT and were pioneers in the early days of computers. This is not surprising. Given that accountancy has information at its heart, *information* technology should have a significant impact on the way accountants do their job.

But there's a perception that the innovative use of IT by finance functions has diminished in recent years. Is this really the case? If so, does it matter? And how should finance functions be engaging with IT developments in the future?

## THE IMPACT OF ERP SYSTEMS

Enterprise resource planning (ERP) systems have probably been the largest finance-related IT investment businesses have made in recent years. While most businesses had automated accounting tasks long before they arrived, ERP systems brought together all the transactions of the business – providing more integrated and comprehensive information for the finance team. They were designed to automate the consolidation and reporting tasks in the process, freeing up finance functions to do more higher-value analysis and business support.

Yet despite their early promise, the implementation of ERP systems has yielded little in the way of innovation. Surveys and academic research suggest no new management accounting techniques have flowed from the new functionality. They also report minimal changes in the role of finance functions as a result of ERP systems freeing up time and space for creativity. Why?

Of course, ERP system implementations are highly complex and many businesses have found it difficult to achieve substantial benefits from them in many areas. There may be resistance to change. And it has typically taken much longer to realise benefits than vendors and users hoped. So we may need to look over a longer time period to identify real shifts.

Finance functions also face particular challenges around innovating through ERP. For example, there are likely to be economic factors: implementing complex and costly functionality to improve the work of finance functions is unlikely to be a top priority for a resource-constrained business.

Then the functionality may not be particularly innovative. ERP systems are usually largely based on established practices, so they're unlikely to introduce radical change. ERP systems can also be highly structured and inflexible. As a result, many finance functions have developed increasingly sophisticated shadow systems, using spreadsheets, specialist tools and reporting systems – such as business intelligence and data warehousing – to support their needs.

Which begs the question: do we find more finance function innovation in the use of these "workaround" systems and new technology such as business analytics?

## UNLOCKING THE POTENTIAL OF BUSINESS ANALYTICS

Business analytics is an extension to previous generations of reporting technology. Its distinctiveness comes from a focus on prediction. By identifying previous patterns of behaviour and correlations between data points, analytics systems predict future behaviour and events. This should provide many opportunities for finance functions to improve their support to the business.

However, previous generations of reporting technology have often under-delivered in practice. At the heart of this failure is the assumption that better information leads to better decisions, and thus better performance. As a result, development efforts have largely focused on improving the tools and the quality of the data, looking to provide the best information possible.

This approach misses the real complexity of decision-making in organisations, the number of factors that influence it and the difficulty in properly evaluating its outcomes. People are not always rational; there may be organisational pressures to make decisions in particular ways; even if decisions are "better", that doesn't necessarily translate into improved organisational performance.

There may be a long way to go before we build a deep understanding of these different elements and improve performance. Analytics technology can certainly help – and is developing quickly into these softer areas. But the key contribution for finance will be engaging with analytics and helping developers and business alike to understand where it works and what its limitations are.

## AUTOMATING INTELLIGENCE

That engagement with the technology, both internally and externally, is critical. Because while the real power of analytics remains to be seen, it does present clear opportunities to change the way decisions are made. That potential is driven in part by "big data", the fashionable name for the vast datasets that are promising to revolutionise the way that businesses understand themselves, their customers and their markets. In particular, there is the growing amount of unstructured data captured from sources such as mobile technology, RFID tags, CCTV cameras, social media and many others.

But coupled with big data are improvements in processing power which enable businesses to mine all this data for correlations and patterns. Take driverless cars. Driving seems to be dependent on human judgement and requires instinctive processing of massive amounts of inputs. At the DARPA Grand Challenge in 2004, driverless cars managed just eight miles before falling off the road. In 2010, Google's car drove more than 1,000 miles with no human intervention.

While driverless cars are a long way from the finance function, the ability to computerise and automate increasingly complex decisions typically thought of as human judgement has profound implications for accountants.

Case work automation is already happening in legal firms. The opportunity to automate increasing amounts of accountancy work will also grow. But this isn't just a threat. Finance functions can also exploit these developments to improve processes and provide better support. For example they can:

- use customer data to predict the success of new products and services, and focus resources;
- improve prediction of sales and costs;
- use analytic tools to identify connections between financial and non-financial indicators.

The power of analytics to date has largely been driven by operations and marketing departments. But as the technology improves, and data volumes continue to grow, finance functions are likely to be under pressure to respond more forcefully to the opportunities and challenges in this area.

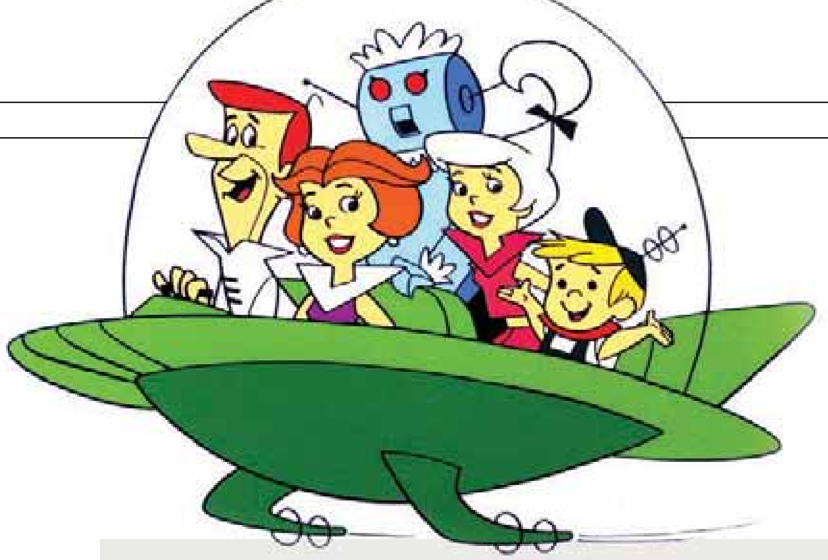
## EXPERIMENTING WITH OTHER TECHNOLOGIES

There are also many other technologies which finance functions could use to change the way they operate. A growing number of surveillance technologies exist that businesses can use to scrutinise exactly what employees are doing and where they are. This includes mobile phones, email, CCTV and GPS systems on company vehicles. But don't think it's all Big Brother. While technologies such as knowledge management systems can be used to record and track employee activities, they're also invaluable for capturing corporate processes and useful information.

Data from these systems can be integrated into control systems that help management spot unusual behaviour – whether it's suspicious or potentially a smarter way of working – and manage employee performance. Email scanning systems already flag language that may indicate an employee is engaging in fraudulent activity.

IT allows us to share knowledge across organisations in ways that circumvent established hierarchies and functional divisions. Crowdsourcing techniques, for example, have been used to gain information about the status of projects, which was much better than the information provided through formal reporting channels.

Then there are new ways of communicating with external stakeholders – such as running AGMs online or using social media to disseminate financial information. That means finance has to manage new risks, too – for example, around social media use or pressure for greater transparency, where reputational and commercial dangers lurk.



We have very limited understanding and little evidence on why recent technologies have not had a greater impact on finance functions

Many of these ideas will have no resonance for finance functions right now. Other ideas may look good but just not work in practice. There's little by way of research on many of the topics where IT and accounting meet – such as ERP, business analytics and new surveillance technologies. As a result, we have very limited understanding and little evidence on why recent technologies have not had a greater impact on finance functions. This makes it harder to take advantage of new technologies in the future.

And that's why accountants and academics should engage more fully with new developments in IT and adopt more experimental approaches. This needs the further development of a diverse profession which embraces people from all backgrounds – and encourages conversations with technologists, academics and general managers.

These conversations are crucial to answering major questions in this area. To what extent should accountants develop deeper analytical skills? What is the role of core accounting skills, such as ethics, integrity, objectivity and rigour, in this era of big data and intelligent computers? How much can we steer the future direction of organisational technology?

The IT Faculty moderated a panel session at the American Accounting Association conference in August on the relationship between IT and accounting, which considered the impact on teaching and training as well as academic research. But that was just one more step on a highly significant journey into the future of finance.

**Kirstin Gillon** is technical manager at the IT Faculty. This article is based on a presentation she and ICAEW Technical Director Robert Hodgkinson gave to the Management Accounting Research Group at the London School of Economics in March, which brought together thinking from both the IT Faculty and the Finance & Management Faculty on the role of finance and IT.

## "I was promised a jet-pack too"

Having worked with Kirstin Gillon on her investigation into the finance function and IT, **Rick Payne** reflects on his experiences and the related research

"What this system will give you is one version of the truth, full drill-down capability and flexible reporting which you can tailor to your needs." That was the promise I was given in 1987 when we were looking to implement a new general ledger. Of course the promise never materialised. The software vendors blamed the implementation, the project managers blamed the unwillingness of the finance department to change and they in turn blamed the software's lack of functionality. It was probably a combination of all three. Has anything changed in the past 25 years?

Many of our members still complain about inadequate, fragmented systems that prevent finance from delivering the service levels they want to provide. Evidence summarised in our research report, *The Finance Function: a Framework for Analysis*, highlights this issue.

While software and hardware capabilities have undoubtedly moved on, so have our expectations – the amount of data we want to manage, the complexity of the analytics we want to carry out and the sophistication of the processes we want to automate. Maybe we have already got the equivalent of jet-packs; it's just that we now want the ability to teleport.

One reason it does not always feel that way is that businesses are constantly evolving and changing. Acquisitions, internal re-organisations and new products and services mean that data structures become outdated, manual work-arounds have to be put in place and errors in data processing creep in. Also, standard charts of accounts, carefully designed when a new ledger is implemented, slowly lose their structures as relatively junior staff bow to the demands of managers requesting a new account to reflect a specific need.

Yet there are examples of IT creating significant changes in how finance carries out its activities. For example, IT developments have been a major facilitator in outsourcing finance activities. While large organisations have been standardising their accounts payable processes, their small supplier organisations can no longer send a standard invoice but have to tailor their accounts receivable processes to each buyer's system.

In our discussions with finance professionals it is clear that some have chosen to engage with IT developments more fully than others. Those that are engaging see IT, including the detailed statistical tools used in analytics, as something they need to understand to exploit its capabilities and manage its limitations. Robert Kaplan, of balanced scorecard fame, has argued that "...to excel at analytics, management accountants will require extensive training in modelling, multivariate statistics, and econometrics". Those who are maintaining distance believe they can rely on others in the IT or marketing departments to take the lead in areas such as analytics and then use the resulting outputs. Whether the different levels of engagement come down to logical argument, interests or ability is a moot point.

I agree with Kirstin that there are many technologies that finance professionals need to keep abreast of. So my choice has always been to try to engage with IT developments – from my days in audit when I took a lead in the use of then 'luggable' Osborne computers with 64kb of memory through to now experimenting with social media and mobile apps. My hope is that this will help me adapt IT developments to the way I want to work, rather than finding IT has forced me to work in a particular way. What choice are you making?

# Technical updates

Our regular round-up of legal and regulatory changes

## TAX

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

### AGGRESSIVE AVOIDANCE

ICAEW has issued a helpsheet to remind its members of the terms of its own Code of Ethics and its guidance on professional conduct in relation to taxation. These have been around for a long time and are updated on a regular basis – but are obviously very topical as the debate on "aggressive avoidance" by both businesses and individuals has become highly public. See icaew.com/TaxFaculty/25014

Meanwhile, the government consultation on a general anti-avoidance rule (GAAR – see snipurl.com/gaarconsult) has just ended. It stated, "The Government agrees that a rule targeted at abusive anti-avoidance arrangements would be the right approach for the UK," although it's clear that it should only catch the most abnormal of tax planning strategies. Please let Ian Young ian.young@icaew.com have your views on any issues raised by the consultation.

### REAL TIME NEWS

By April 2013 most employers will be reporting PAYE using Real Time Information (RTI) and all employers will be expected to do so before October 2013. HMRC has updated its FAQs on using RTI (hmrc.gov.uk/rti/employerfaqs.htm). It has also expanded the RTI pilot for expat workers. And it has released a video tutorial for employers curious about the new RTI procedures – http://bit.ly/NlLEoe

Separately, HMRC has published a consultation document, *Securing compliance with RTI - late filing and late payment penalties* (snipurl.com/RTIpens), inviting views on how to maximise compliance and on the design of a penalty system to support the rules. Under RTI an employer or pension provider has to send HMRC details of every payment made to each employee/pensioner, on or before the day that payment is made.

### SHORTER P46

HMRC has created a single page version of form P46 called P46 (Short). Employers can use this to collect information from new employees who do not have a P45. The employer should then use the details from the P46 (Short) to complete a full form P46 for HMRC online. See hmrc.gov.uk/forms/p46.pdf

### EIS AND VCT: LARGER COMPANIES

Legislation to increase the company size threshold for the Enterprise Investment Scheme and Venture Capital Trusts was included in Finance Act 2012, opening up these tax efficient forms of investment to much larger companies.

- The employee limit is increased to 250 (from 50).
- The size threshold for gross assets increases to £15m before investment and £16m after (currently £7m before and £8m after).

The EIS annual investment limit for individuals was increased to £1m from 6 April 2012. The annual investment limit for qualifying companies was increased to £5m for shares issued on or after 6 April 2012. This limit takes account of any other risk capital aid received, and VCTs are prohibited from making any investment which breaches that limit.

### PAYE POOLING

HMRC has announced no further developments on PAYE pooling, which it was considering last year to give closely connected employers the option of being treated as a single entity for PAYE purposes.

It is allowing employers currently using informal agreements to pool payrolls to continue to do so – but no new applications to pool will be considered.

### SENIOR ACCOUNTING OFFICERS

The Senior Accounting Officer (SAO) regime requires a senior officer of companies with turnover in excess of £200m and/or a balance sheet in excess of £2bn to formally certify each year that their company has taken reasonable steps to ensure that it has "appropriate tax accounting arrangements".

The light touch application of the regime, which started in 2009, is now over and HMRC is likely to scrutinise returns by "non low-risk" companies or groups to see whether there is evidence of Board oversight, risk identification and assessments carried out throughout the year. Overseas activities of UK companies are now included within the regulations – and SAO rules also apply where insolvency procedures are underway.

## FINANCIAL REPORTING

You can find out more on the latest from the Financial Reporting Faculty, including UK GAAP and IFRS standards and consultations, at icaew.com/frf

### IFRS 10-12 TRANSITIONAL RELIEF

The International Accounting Standards Board (IASB) has amended IFRS 10-12 to provide transitional relief. It has issued *Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance (Amendments to IFRS 10, IFRS 11 and IFRS 12)* which contains the following amendments

- Clarification of the transition guidance in IFRS 10.
- Details of the provision of additional transition relief in IFRS 10, IFRS 11 and IFRS 12, limiting the requirement to provide adjusted comparative information to only the preceding comparative period.
- The removal of the requirement to present comparative information for disclosures related to unconsolidated structured entities for periods before IFRS 12 is first applied.

The effective date of the amendments is annual periods beginning on or after 1 January 2013, which is aligned with the effective date of IFRS 10, 11 and 12.

The Financial Reporting Faculty's factsheet on *Interests in Other Entities* – which is available exclusively to faculty members – has been updated to reflect these amendments.

### REVIEW OF THE IFRS FOR SMES

The IASB has launched its first comprehensive review of the IFRS for SMEs by issuing a request for information seeking public views on whether there is a need to make any amendments to the standard and, if so, what amendments should be made.

The request for information asks specific questions on particular sections of the IFRS for SMEs, as well as general questions about respondents' experience with it. Respondents are encouraged to raise any other issues that they want to put forward.

The deadline for responses is 30 November 2012. Any revisions arising from this review are expected to be effective from 2015.

### FACULTY AUTUMN ROADSHOW

The Financial Reporting Faculty's autumn roadshow, which focuses on today's key financial reporting issues as well as those on the near horizon, kicks off in Wakefield on 25 October 2012. Further events will take place around the country throughout November and December.

This half-day roadshow will provide an excellent first opportunity to understand the practical implications of the new UK GAAP regime for your business: the options you have, the choices you need to make and the impact on your systems, training and reported numbers.

Participants will also benefit from practical help in complex areas of UK financial reporting of current concern and from an overview of recent and forthcoming changes to both UK and international accounting requirements, including an update on the new EU regime for micro companies.

Separate half-day IFRS roadshows in London and Manchester will provide expert commentary on new international standards applicable in 2012 and an update on other developments in IFRS and listed company reporting relevant to UK companies.

Prices begin from just £90 inclusive of VAT for each individual half-day event. If you are interested in attending both events, prices begin at just £144 inclusive of VAT.

## EMPLOYMENT LAW

This section is based on the monthly bulletin of law firm Herbert Smith – but does not constitute legal advice and should not be relied upon as such. See herbertsmith.com

### EXECUTIVE REMUNERATION

Proposals for reform of rules on executive remuneration are well under way – applying to quoted companies, with reporting requirements likely to kick in for financial years ending after October 2013. The key measures are the requirement for a binding vote by shareholders on future remuneration plans; and an advisory vote where shareholders approve the implementation of remuneration policy over the previous year.

### RESTRAINING EX-EMPLOYEES

Employers should ensure employees' contractual job descriptions are kept up to date – and review post-termination covenants, too. In *Ranson v Customer Systems plc*, the Court of Appeal (CA) decided that an employee with no express contractual duty to develop clients in a specific market sector could discuss his own future plans to set up a competing business with potential clients in that sector. In *Patsystems Holding Ltd v Neilly*, the High Court (HC) ruled that a covenant, which was unreasonably wide for an employee's original job, but reasonable for a subsequent promotion, would need to be expressly re-agreed to be enforceable. And in *CEF Holdings v Mundey*, the HC ruled employers looking to enforce restrictive covenants should ensure employees have an appropriate notice period.

### UNFAIR DISMISSAL

Loss of trust and confidence in an employee can amount to "some other substantial reason" for dismissal. But if employers are found to be culpable for the breakdown in some way, the dismal might still be considered unfair, despite a genuine loss of trust. In *Governing Body of Tubbenden Primary School v Sylvester*, the Employment Appeal Tribunal (EAT) looked beyond simple loss of trust at the "immediate history" of relations with the employee – which included censure for something the employer had previously condoned.

### HOLIDAY: SICKNESS AND CARRY-OVER

Case law has established that an employee who falls sick before scheduled statutory holiday should be allowed to reschedule the holiday at another time (Pereda). The European Court of Justice has confirmed that the same applies where the employee falls sick during statutory holiday. The employee can reschedule the period of holiday affected by illness.

Meanwhile, the CA has upheld an EAT ruling that where an employee is unable or unwilling to take their entitlement to four weeks' statutory holiday in the current holiday year due to being on sick leave, an employer must allow the employee to carry over this leave into a new holiday year even if the employee has not expressly requested this. More detail at snipurl.com/holidaysick

### EMPLOYMENT LAW REFORM

The government's employment law reform agenda continues with changes to protected settlement discussions, equal pay audits and collective redundancy consultation.

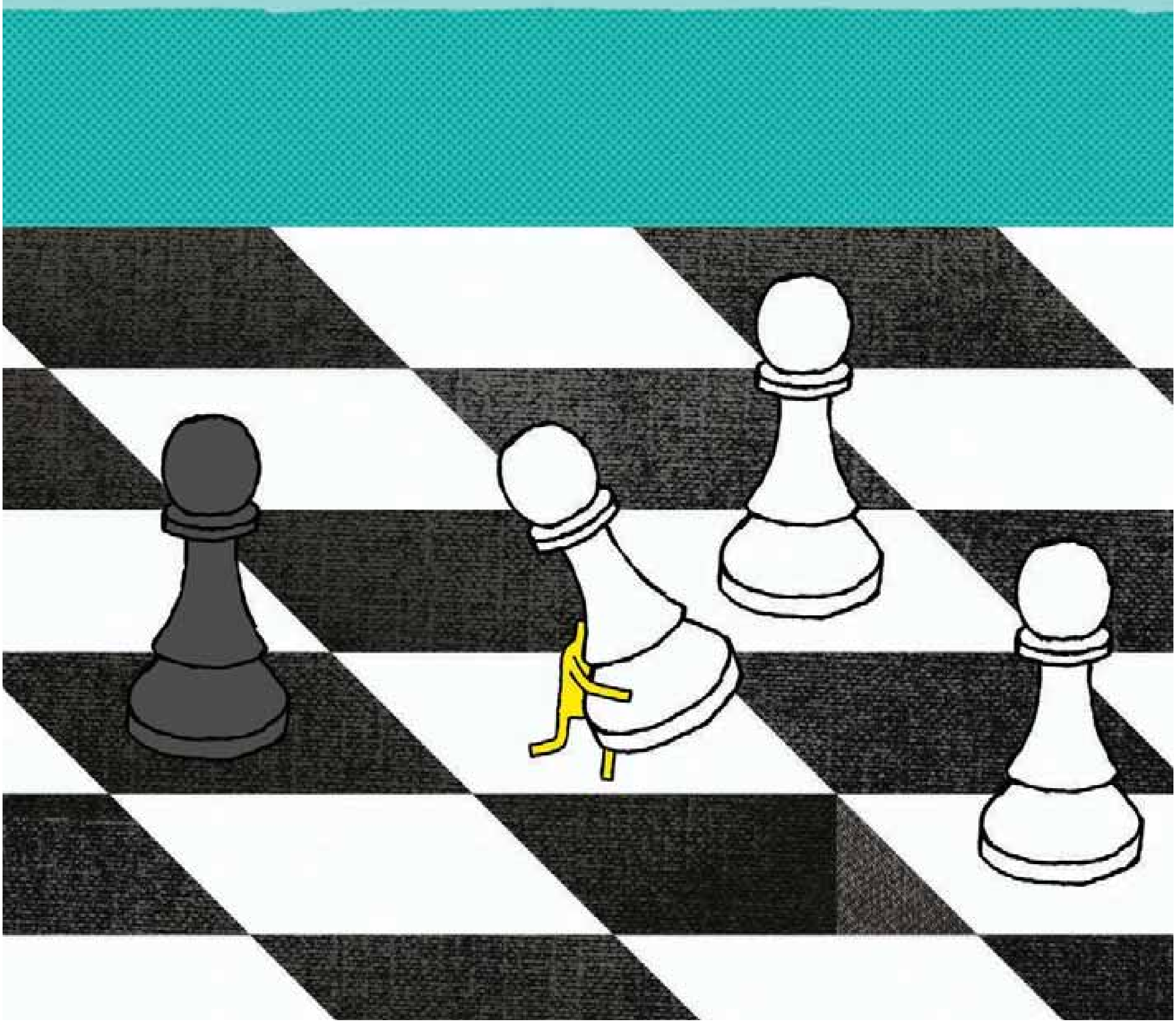
An amendment to the Enterprise and Regulatory Reform Bill aims to provide that an offer made or discussion held with an employee with a view to terminating employment by agreement cannot be taken into account in unfair dismissal proceedings – although this is unlikely to be of much use in most cases. There is no protection if an employee brings an automatically unfair dismissal or discrimination claim, and few employers are likely to be in a position to discount the possibility of such claims.

The government is going ahead with its proposal to allow employment tribunals to order employers to conduct a pay audit in cases of pay-related gender discrimination – although there'll be a consultation on what such audits will entail.

And it has just ended a consultation period on a revitalisation of collective redundancy rules – centred around a reduction of the period of consultation, but also including codified guidance for other aspects of the process. The interaction between the consultation rules and TUPE is also being reviewed by BIS.

# STRATEGY BEFORE STRATEGISTS

Managing a business can be risky, but our medieval counterparts built empires against widesread war, famine, plague and piracy. **Morgen Witzel** looks at some ancient approaches to managing risk



IKON/TIM ELLIS

We take the idea of business strategy pretty much for granted today. Every business has, or should have, a strategy. Large companies have departments devoted to planning strategy and hours, even days are spent in meetings discussing it. Business schools have departments dedicated to researching and teaching strategy, and few undergraduate or MBA students escape without taking at least one course covering it. Strategy, like love, is all around us.

But it was not always thus. It may come as a surprise to learn that the concept of business strategy originated as recently as the early 1960s. Two seminal books – Igor Ansoff's *Corporate Strategy* and Alfred Chandler's *The Visible Hand* – defined the subject for the first time. Before that there had been something called 'business policy', a vague field that occupied the interests of a few researchers, and before that... in formal and theoretical terms, not much.

This poses an interesting question: What did business leaders and managers do in planning and direction before our own time? How did people make strategy before strategy was invented?

One theory has it that there was no need for strategy before modern times. Businesses were tiny and served only their own village or community so they simply responded to local needs as these developed. There was little or no economic growth, so there were no challenges for businesses to respond to. They merely existed in a steady state.

That theory falls down as soon as we start to look at the facts.

First, there certainly was economic growth. Economic historians tell us that the economy of England grew by an average of 5% per annum between 1086, the year of the Domesday Book, and 1300 – a rate rather higher than the average over the past few years. That average masks periods of very fast growth as well as several sharp and deep recessions. Businesses certainly faced many challenges during these periods.

And second, there were large businesses, businesses that traded across international boundaries and employed thousands of people. The East India Company in the 18th century operated on five continents; it was their tea that American patriots poured into Boston harbour shortly before the American Revolution began.

The economy of England grew by an average of 5% per annum between 1086 and 1300 - higher than the recent average

## RESOURCES AND MARKETS

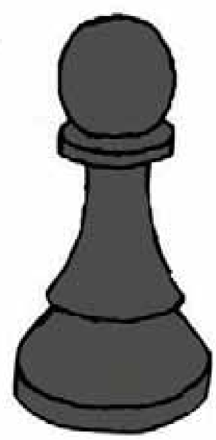
Most writings on the subject before the late 20th century discuss military strategy, and early business leaders were familiar with the works of writers such as the Chinese general Sun Tzu (5th century BC) or the Roman writer Vegetius (5th century AD). But there are limits to how useful military strategy can be for business. It seems clear too that there was a great deal of emulation – people looked at what successful businesses had done, and then tried to apply the same recipe to their own work.

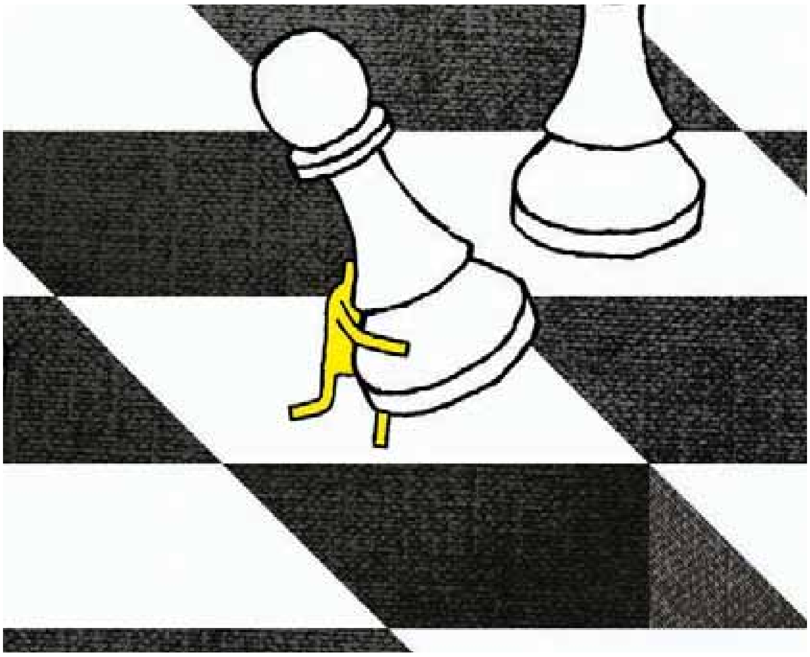
Looking at business action and behaviour can tell us a great deal about strategic intent. In their book *The Origins of Globalization*, Karl Moore and David Lewis analysed businesses in ancient Mesopotamia, Phoenicia, Greece and Rome. They concluded that there was a clear awareness of strategy and certainly informal strategic planning.

Modern theorists on strategy sometimes classify strategies into two types: resource-seeking strategies, which are focused on gaining access to land, natural resources, components, or human or financial capital, and market-seeking strategies, which are focused on gaining access to new markets or further developing existing ones.

As Moore and Lewis show, businesses in the ancient world engaged in both strategies. For example, traders in Ugarit, one of the most important trading cities in the ancient Mesopotamian region (north modern Syria), knew there was demand for iron. They also knew about stocks of iron ore in the mountains of Anatolia (modern Turkey) and matched demand and supply, positioning themselves between the two.

As they grew, these firms began looking for new markets but also knew sources of supply. Trade routes developed to the highlands of Persia, then with northern India, ultimately with China. Each expansion was driven by the quest for both markets, and resources to supply to those markets. In his book Rome and the Distant East, historian Raoul McLaughlin shows how by the time of the





Roman empire, traders were making the journey from Rome to China almost as a matter of routine.

### ACCEPTING RISK

These early resource/market seekers were to a large extent opportunistic – and opportunism is one form of strategy. But we can see too that there was awareness of key strategic issues. It was known, for example, that businesses needed to grow: larger businesses were better able to withstand shocks. It was also clearly understood that businesses needed to manage risk, and we can see how early strategists thought and behaved when we look at risk.

European businesses in the Middle Ages, such as the Medici Bank, operated in an environment with levels of risk that we would probably find intolerable today. War, piracy, epidemics, catastrophic storms and shifting local and regional politics all threatened the existence of every business. According to one commonly used metric of the day, maritime trading firms should predict costs and profits so if they sent out five ships and four failed to return, the profits from the fifth should cover the losses incurred by the others. It's clear that business leaders and managers needed a high tolerance for risk. One of the first writers on managerial competencies, San Bernardino of Siena in the 15th century, listed the ability to accept risk as one of the four things required of any manager – the other three were efficiency, hard work and the acceptance of responsibility.

Fully aware of the perils of their environment, medieval business leaders tried to lay off risk as much as possible. One common method was through diversification. The Medici Bank started out as a small money-lending operation, but as it grew it diversified into trade, manufacturing of wool and silk cloth, and even mining. A relatively small business, like that of Francesco Datini operating in 14th Century Prato, might trade in foodstuffs, cloths, spices, arms, corn and other commodities, as well as engage in banking.

Businesses also diversified geographically. Datini and his partners usually had operations in four or five cities at once, shifting from place to place as economic and political conditions changed.

From the letters that survive – Francesco Datini left behind more than 100,000 letters written over the course of his career – we can see that this was 'planned opportunism'. Diversification meant that risk was spread evenly. Nor did he simply react to events as they happened. He estimated he spent half of his time engaged in gathering information; hence the voluminous correspondence with partners and agents and contacts, as he tried to gauge where future opportunities and risks might lie so that he could switch resources to be ready.

The Medici had operations in most of the cities of western Europe… and relationships as far afield as Iceland and China

The Medici had operations in most of the main cities of western Europe. They were involved in the gold and salt trade across the Sahara, had permanent agents in half a dozen cities in the Middle East, and further agency relationships as far afield as Iceland and China. A later large business, the Augsburg-based House of Fugger, which took over many of the Medici's operations, was involved in mining, manufacturing, trade and banking, and had major operations in Spain, the Netherlands, Austria, Germany, Italy and Ottoman Turkey.

### THE CHALLENGES OF GROWTH

Datini was certainly aware of the principle of fortuna, described by the Florentine statesman Niccolò Machiavelli in his most famous work on strategy, *The Prince*. Fortuna is sometimes translated as 'luck', but in fact encapsulates all the forces at work in the environment around us, things that are beyond our control but nonetheless have an impact on us and our affairs.

Successful leaders, said Machiavelli, were not those who tried to defy fortuna, but rather ones who looked at the chaos and circumstances around them, spotted opportunities and moved to seize them. (This kind of approach to strategy is still used today by many Chinese firms, famous for the ability to seize opportunities, often more quickly than their Western counterparts).

Diversification inevitably meant growth but it also presents challenges of control, which is one of the reasons why diversification has gone out of favour in our own time. The concept of 'core

## FURTHER READING

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competencies', concentrating on the few things that we do really well, may work now, but it would have been commercial suicide in the Middle Ages.

Instead, medieval businesspeople evolved new organisational forms that would allow them to grow rapidly without losing flexibility or focus. The core concept behind these new forms was the limited life partnership. Instead of establishing permanent corporations, medieval Italian businesses consisted of partnerships intended to last for no more than two or three years.

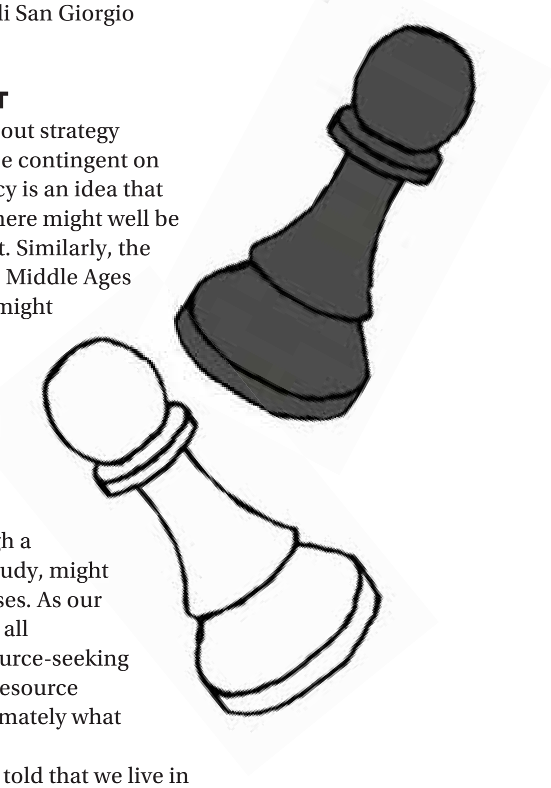
Some partners contributed capital, others brought expertise. When the partnership expired it could be renewed on the same terms, renegotiated on different terms, or terminated. New partners could be brought in, or existing ones might bow out. In any given year, Francesco Datini was involved in anywhere from six to 14 partnerships, each with between two and 10 people. Similarly, the Medici Bank was a gigantic series of interlocking partnerships, structured both horizontally and vertically.

It is almost impossible to calculate how many such partnerships existed in the Medici firm, as the number changed each year. Giovanni d'Amerigo Benci, the long-serving general manager of the Medici bank was in a partnership with Cosimo dei Medici the head of the firm, and also with the heads of each major trading station and manufacturing division; these heads in turn had their own partnerships, and so on down the line.

Though technically complex to manage, this system gave firms a wonderful degree of flexibility. They could shift focus suddenly to avoid undue risk and take advantage of new opportunities. Partnerships also made communication easy across the organisation – the Medici were renowned for their ability to collect information, analyse and plan. Guided by Cosimo dei Medici and Giovanni di Benci, they always seemed to be one step ahead of their rivals. But other firms used the same model and prospered, too, such as the Society of the Bardi in Florence or the Banco di San Giorgio in Genoa.

## LESSONS FROM THE PAST

What does all of this teach us about strategy today? First, strategies need to be contingent on time and place. Core competency is an idea that (seems to) work well now, but there might well be times and places when it did not. Similarly, the partnership concept used in the Middle Ages was very good for the time, but might be harder to manage today – though new communications technologies and social media might also mean we should give the idea another look.



Second, the distinction between resource-seeking and market-seeking activity, although a useful construct for academic study, might not be very relevant for businesses. As our Mesopotamian ancestors knew, all businesses need to be both resource-seeking and market-seeking. Matching resource supply to market demand is ultimately what businesses do.

And finally, we are constantly told that we live in risky and challenging times. Although our day has nothing on the Middle Ages when it comes to risk, there are still plenty of challenges out there. Perhaps we need to learn something from the opportunistic approaches of the past, become less wedded to formal planning and execution and learn to think about risk and how to manage it on an ongoing basis. Francesco Datini might serve as a useful example to us all.

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# From the faculties

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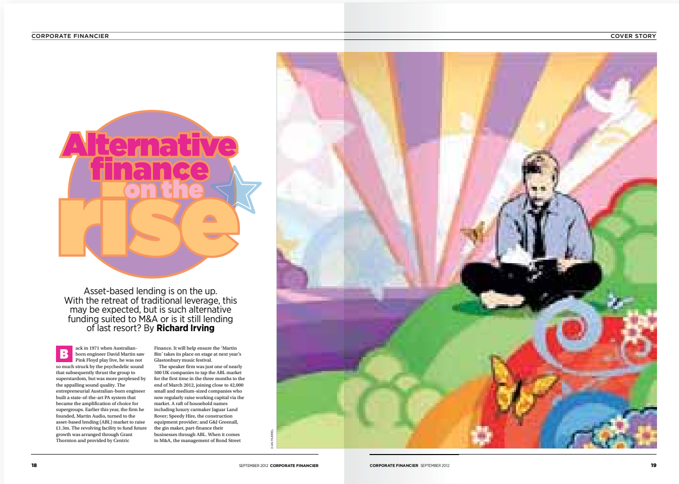


## CHARTECH

### BUILDING TRUST IN THE DIGITAL AGE

The IT Faculty has a new thought leadership report out, tackling the issues of privacy, property and security in the digital era – and it gathered to debate its findings in June. Prompted by high-profile IT failures in these areas, the challenge is not simply beefing up digital risk management to avoid errors. It's about ensuring that opportunities are not missed when trust from consumers and others in digital services breaks down – or when legislation or controls are put in place to restrain the use of information.

Neither can digital risk management be treated in isolation. We need a clear framework articulating the rights and responsibilities that organisations have over information in an age when there's more of it – and it moves around more easily.

It's not just about compliance with laws on, say, privacy, either. "Trust" has an implicit ethical dimension. And it may be that organisations going above and beyond regulatory requirements gain a commercial, strategic benefit. Intellectual property, too, becomes a multi-faceted problem in the digital age, posing questions about the adequacy of IP rights, litigation and theft.

Security is a major concern. Surveys suggest 90% of organisations have faced an information breach – making it crucial to embed good digital security practices and deploy better tools to cope with a networked and increasingly diverse digital ecosystem.

For more from the IT Faculty, visit icaew.com/itfac

## CORPORATE FINANCIER

### ALTERNATIVE FINANCE ON THE RISE

In the era of nervous banks and cash-starved business, asset-based lending (ABL) – raising money using invoices, stock and even cashflow as collateral – is on the march. The Asset Based Finance Association says £15.4bn was advanced against invoices and other assets in the first quarter of 2012 – up 4% year on year. Meanwhile Bank of England data shows net lending to UK businesses fell £9.6bn in the same period.

It's not just SMEs that are frustrated with unpredictable overdrafts. Even larger businesses such as Jaguar Land Rover use ABL in their funding mix. And it's a crucial part of the deal-doer's armoury, helping to fund buy-outs and M&A transactions.

Proponents argue the transparency of ABL makes it an ideal corporate finance tool, giving near-total clarity of the cash that can be raised from a target as part of a deal. Many private equity firms, starved of bank debt, are using ABL for their investments. The industry has responded with more sophisticated ABL packages looking across a broad range of assets and covenants less onerous than on term loans.

Given the more favourable treatment of ABL loans under the regulatory regime, it's no surprise that banks and other finance houses are happy to oblige this new appetite for asset-backed lending. It's still a welcome arrival as a mainstream funding option for FDs and investors.

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

## FS FOCUS

### ONE STEP BEYOND

Money laundering is a major concern for all accountants, both in practice and in business. Susan Grossey's look at how to minimise the risks in financial services – made topical by the recent case of HSBC in Mexico – has lessons for any firm involved in handling or advising on client funds and any business working with counterparties they don't know intimately.

The key is to have sound policies in place and a money laundering reporting officer (MLRO) sensitive to the high-probability risks. Clients should be assessed and high-risk ones flagged for special due diligence – a failing that helped cause lapses at Habib Bank in Zurich, leading to heavy fines being issued in May.

Grossey's three steps to compliance are straightforward. First, understand the "enemy" – money laundering and terrorism financing are sophisticated and firms should make sure they're up-to-date on the risks. Second, run a formal risk assessment on your own business and its clients. Third, conduct regular reviews of client activity – and ensure you source all the information about them needed to maintain a complete and up-to-date picture.

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