The Institute of Chartered Accountants in England & Wales

Faculty of Finance and Management

Finance & Management

Issue 76 JUNE 2001

Benchmarking the finance function

A special four-page feature on how to test yourself against the best

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THE NEW AGE

Businesses behaving badly...

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A selection of sites about benchmarking

Readers interested in our benchmarking feature (*page 3*) may find these web sites helpful:

Benchmark Index – useful web site from the Small Business Service providing a tool that enables small businesses to compare themselves with other companies using a benchmarking sampler (based on data from 2000 companies). The site also provides free downloadable copies of their report 'Closing the gap' and their newsletter 'Benchmark Index' (which includes articles and case studies).
www.benchmarkindex.com

The Benchmarking Centre (UK) – includes detailed case studies of five companies who won or came close to winning the European Best Practice Benchmarking Award.
www.benchmarking.co.uk

Capital Expenditure ScoreBoard (Capex) – the on-line database for the Capex Scoreboard is hosted by the DTI Innovation Unit web site, described as providing 'companies and their shareholders with information about capital expenditure so that they can benchmark their expenditure against their competitors in the UK and abroad'. Users can search on UK or international companies, by financial year and sector - or by company name.
www.innovation.gov.uk/projects/capex_scoreboard/capexscoreboard_fr.htm

Global Benchmarking Network – web site representing the alliance of leading worldwide benchmarking centres in 17 countries, with direct weblinks to each centre.
www.globalbenchmarking.org

The E-Business in Manufacturing Web Site – research site supported by the DTI and a number of IT vendors. The site includes the findings of the September-October 2000 research project, and the option to benchmark your e-business strategy against your choice of manufacturing sector. Results are emailed back, and give a comparison of your answers with the average for a group of similar sized companies with the same industry sector profile.
www.benchmark-research.co.uk/ebusiness.htm

The Benchmarking Exchange and BenchNet: Benchmarking Portal – subscription based portal with a US flavour, including self-diagnostic tools, benchmarking surveys, a forum for discussing benchmarking metrics and a database of articles.
www.benchmarking.org

The ICAEW Library & Information Service's award-winning links pages can be accessed at www.icaew.co.uk/library.htm along with a series of Knowledge Guides.

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Comments and suggestions about FINANCE & MANAGEMENT should be addressed to Chris Jackson BA FCA, Head of the Faculty (see left).

POSSIBLE WITHDRAWAL OF BREATHE ISP SERVICE

The Institute has been notified by the internet service provider, breathe, that the company has been put up for sale by its owners, Great Universal Stores. Breathe, which has been providing a free ISP service to members, is advising that it would be wise to look at alternative options for the provision of ISP services in case the result of the sale talks means that the service is terminated.

Sarah Alder, head of digital communications at the Institute, says: "We would advise any member who is currently using the breathe ISP to look for an alternative service immediately. We are not recommending any individual service because the best service for any individual member is dependent on so many variables."

However, she suggested that the following web sites might be helpful: www.ispreview.co.uk (an overview of the market) and www.internet-magazine.co.uk (a monthly review of ISPs).

Faculty faces

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Benchmarking the finance function

In this special feature, three leading benchmarking firms explain how their services apply to the finance function. Here, **Chris Jackson**, head of the Faculty, sets the scene.

The finance function is under threat. But probably no more than any other part of the organisation where cost cutting, performance measurement, right-sizing and other spells of alchemy have been cast. Other departments often see us – the finance function – as sacrosanct while we calculate how many positions can be saved elsewhere. But we need to lead by example and ensure that the finance function is 'best in class'. The first step for the finance director is to find out where his or her department stands against the rest of the market. This is where benchmarking fits in.

There are two ways of approaching benchmarking the finance function. The first is to compare directly with another finance function. If the organisation is big enough you can compare different finance functions within the group. Or you can contact an organisation which can put together FDs who want to work with others with similar aims. In this way you can work together and learn from each other's strengths and weaknesses. The downside is that you don't know where you stand against the wider world.

The alternative is to compare your department against a database of other departments. Such databases are maintained by large consultancies such as Hackett/Answerthink, PricewaterhouseCoopers and Gunn Partners. They will ask you to complete a range of questions and send you your results compared with a suitable group of comparators. This allows you to prioritise, identify big wins and fix them. This can be done in-house or you can use consultants.

Major findings of benchmarking are that staff spend too much time on transaction processing and not enough on value added activities. For large organisations, the solution can include outsourcing functions or setting up shared service centres for transaction processing.

There are two downsides to a benchmarking exercise. First, it can take up a large amount of time and money. Second, everyone wants the results without the effort of collecting data for one's own function. It is obvious that if the data were given in this way, in a short time the result would be to destroy the database – if no one added to it. Although some benchmarking data are available on the internet, I have not discovered comprehensive data on finance function activities. Let me know if you know of it.

For this issue of *Finance & Management*, we looked for consultancies which specialise in benchmarking the finance function; we found Hackett, PricewaterhouseCoopers and Gunn Partners. We asked them to write about shared service centres, the monthly close and budgeting showing typical benchmarks, typical weaknesses and some fixes. We hope this will provide you with some insights and start you thinking about your own finance function.

PricewaterhouseCoopers

Focus on the competition

PricewaterhouseCoopers's benchmarking service – the Financial Management Benchmarking Programme (FMBP) – gives companies the opportunity to identify gaps between themselves and world-class targets. It forces clients to focus on the competition and act promptly.

The PricewaterhouseCoopers study focuses on the core finance activities, ie general accounting, revenue, expenditure and profitability and cost management. Its key traits include:

- internal benchmarking – useful if there is more than one site within a company;
- external benchmarking – across a range of peer groups including industry, location, role, transaction volume, revenue banding and customer strategy;
- best practice – offering case studies on process improvement; and
- an executive summary – to highlight key trends and evaluate the cost savings that can be achieved by moving towards the target.

Outputs

A client can potentially receive up to 600 performance measures and business drivers which explore the concepts of cost, cycle time, efficiency, quality and value added activities. The sheer depth allows improvement opportunities to be identified easily and hence accelerate the action phase.

The measures are normalised by revenue to facilitate comparability across different companies. This means that any size company is eligible to compare performance.

Costs and logistics

The cost of the study varies, depending on the level of participation. Pricing begins at £2,000. Processing time is guaranteed at a maximum of two weeks, though in most cases this could be shorter.

SAMPLE MEASURE – THE MONTHLY CLOSE

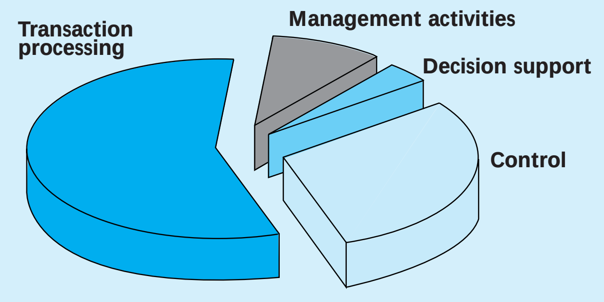
The monthly close is conducted as part of the financial reporting process. The charts of accounts are closed and the trial balance is generated to depict the financial position of a company at a particular point in time.

Contributing factors in the closing time

The pressures within finance to be more cost effective with streamlined processes has resulted in firms focusing on their closing operations, which are often regarded as slow and inefficient. Specific factors that affect the closing time of a company include:

- frequency of performing the interim closings;
- presence of foreign currency denominated books;
- quality of the company's internal control system;
- approach to accruals;
- extent and complexity of all allocations;
- efficiency of the local transaction systems;
- effectiveness of sub-ledger systems;
- accuracy of day-to-day transaction postings; and
- prevailing culture of the finance function.

VALUE ANALYSIS OF TIME WITHIN GENERAL ACCOUNTING



Best practice

PricewaterhouseCoopers's benchmarking findings indicate that the median performance for closing the books is five days, for an individual site. Best practice sites have been able to obtain closing time in three days, with some being able to close their books in one day or less.

Quick fixes

There are several quick fixes that can reduce the closing cycle time:

Hackett

Maximising the benefits

'Old economy' best practice remains the cornerstone of success in the 'new economy', according to **Hackett Benchmarking & Research**, with success depending on best practice in all areas: people, process and technology.

Our findings are the result of decade-long best practice benchmark studies, culled from performance data about more than 1,600 organisations (including 80% of the Dow Jones Industrials, two-thirds of the Fortune 100 and 60% of the Dow Jones Global Titans Index). Through our best practice benchmarking, companies can compare their processes with others' and devise solutions – both 'quick fixes' and long-term strategies. For finance executives, our study pinpoints some intriguing best practice developments:

- despite the widely held notion that shared services are a best practice, only 48% of companies have implemented them;
- the cost of finance as a percent of revenue at average and first-quartile companies has levelled off at about 1.05% and 0.93%, respectively. However, inefficient finance organisations lag far behind even average performers; and
- only a small group of companies are leveraging the maximum value from their technology investment over the last decade. These world-class companies incorporate web browsers and self-service applications to reduce the resources needed for traditional transaction processing, and finance operation costs are 42% lower than average.

SAMPLE MEASURE – SHARED SERVICE CENTRES

Of these findings, implications surrounding shared services utilisation affect European companies most significantly. Operating quickly at a low cost is no longer simply a luxury.

Currently, European companies process 9,913 supplier invoices per full-time equivalent (FTE) employee in payables and 22,986 customer invoices per billing FTE. By contrast, US companies process 17,407 supplier invoices per FTE employee in payables and a whopping 195,183 customer invoices per billing FTE.

Several barriers keep many European companies from incorporating shared services best practice. One of the most common: running numerous stand-alone operations across multiple locations, limiting opportunities for consolidation and cost savings. While companies across the globe have achieved economies through consolidation, many European companies have lagged behind.

Poised for change

Now, European companies are poised for change. The euro's entrance helps improve the efficiency of financial processing by eliminating multiple currency issues and simplifying the payment structure. And instead of forcing companies to operate finance

- *rationalising the chart of accounts within cost centres/business* – by reducing the complexity of the general ledger, a company can reduce the time to consolidate its subsidiaries. We have found that companies that fully standardise their chart of accounts achieve a 20% improvement in time to close;
- *using a soft close each month then a full one at quarter end* – this means letting the general ledger and feeder systems run their course and then reporting only those key measurements critical to the business. By using large materiality tolerances (for reclassifications, accruals, and errors) during interim months it does not need month-end accruals or allocations that are unnecessary for managerial purposes;
- *making a fast close a business priority and managing it as such* – management wanting a fast close needs to articulate the benefits to the whole business and prioritise it as a core finance process. This would involve using check-off lists, timing schedules and carrying out post-mortems to highlight errors; and
- *conducting some reporting weekly* – this could involve, for example, sales, variances and forecasts. This will minimise month-end surprises.

Long term

Benchmarking is a crucial way of finding out how other companies are performing and avoiding misplaced complacency. Longer-term improvements could feature adoption of shared service centres, where use of common policies, chart of accounts, accounting procedures and streamlined processes reduces cycle times. Automation of the general accounting process can also cut cycle times.

Companies that have greater than 50% of their journal entry line items automatically linked to the finance systems have a monthly close time half that of those using manually processed journals.

The virtual close is the ultimate aim, giving the ability to close the books at any time. It is considered a continuous process that builds over a month and involves real-time monitoring of critical information.

Conclusion

In summary, the closing process is crucial to the financial reporting process and the finance department needs to concentrate on keeping this to a minimum.

For any queries, please contact the PricewaterhouseCoopers benchmarking group on global.benchmarking@pwc-global.com

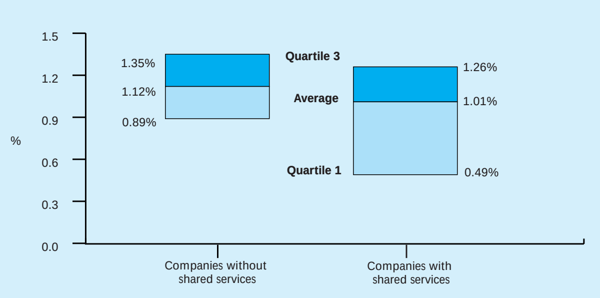
and procurement functions in their home countries, as once legislated, updated regulatory statutes open opportunities for cost savings by allowing consolidation of these functions in one strategic location.

Previously, European companies saddled with multiple currencies and outmoded statutes found technology investment too expensive. But the advent of the euro and updated statutes mean such companies can more easily adopt shared services best practice and improve efficiencies.

It is important to note that shared services rarely benefit companies that implement them without deploying best practice across people, process and technology components. To illustrate this point, consider the companies in our study labelled ‘average’. These companies still need improvement in incorporating best practice throughout their enterprise; they suffer from a lack of standards and inefficient procedures. Of the average companies, those with shared services spend 1.12% of revenue on finance costs, while those without shared services spend 1.01% – a virtually negligible difference.

However, in world class companies the benefits of incorporating shared services shine out. These top performers gain huge savings when they implement both shared services and best practice across their enterprise, while top performers without shared services spend 45% more on finance processing.

FINANCE COST AS A PERCENTAGE OF REVENUE



So what quick fix can European companies employ to get them on the road to shared services best practice?

- start with standardised policies;
- integrate standard processes, and common applications and methods for operating business units; and
- review the number of approvals and copies required to process a payment – can this be reduced?

Companies that conduct a thorough review of current policies, with a distinct focus on standardisation, will reap the benefits once shared services best practice is adopted.

Hackett Benchmarking & Research is a part of Answerthink. It operates European offices in London and Frankfurt. Those interested in the benchmarking programme should call Richard Roth on 001 330 656 3110, or visit the web site at www.answerthink.com/hackett

Gunn

Individual best practice

Gunn Partners, an Exult company, describes itself as one of the 'thought leaders' in the transformation of administrative functions and focuses its consulting practice on strategic advice to the finance, human resources, purchasing and information technology functions.

In the early 1990s, productivity-oriented benchmarking represented the first real breakthrough in performance assessment. Gunn Partners recognised, however, that the real client breakthroughs have come from the application of individual best practice, and our focus in recent years has been on benchmarking that searches for examples of individual best practice and quantifies the impact of adopting those practices. The research supporting this work is conducted by the Exult Process Intelligence Centre (EPIC).

EPIC provides clients – on an annual subscription basis – with access to the real-world experiences and innovative, yet proven ideas of practitioners and thought leaders.

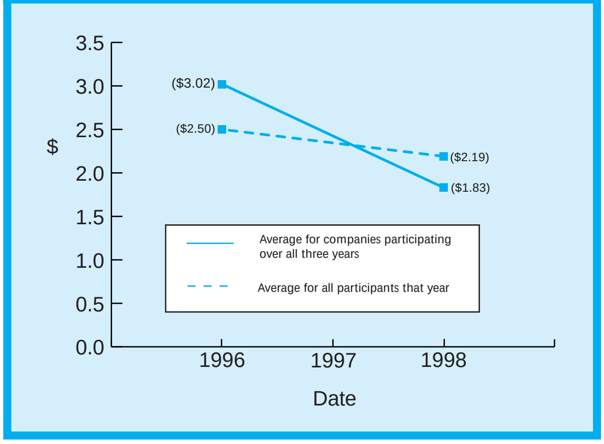
The methodology is distinct from that of other benchmarking organisations in several ways:

- deeper base of facts about individual processes (eg payroll) and sub-processes (eg timekeeping), essential to quantifying the impact of differences in processes and practices;
- complete and unconstrained visibility of data;
- communities that are dedicated to achieving superior results. Through periodic conferences, site visits, webcasts and EPIC member web site, we eliminate barriers between members addressing similar issues; and
- unlimited access to information.

SAMPLE MEASURE – ACCOUNTS PAYABLE

Accounts payable (AP) is a key process within the purchase-to-payment arena and one for which we have a long history of results. Productivity benchmarking identifies the per-unit cost of the process, the savings to be obtained by driving the cost to median or first quartile and a list of practices associated with top performing companies. To improve the processes, however, people also need insight into the way that specific practices are deployed in other organisations and the resulting performance change.

AP COST PER LINE ITEM



Quick(ish) fixes

In our work with a number of 'Global Top 1000' companies, we have facilitated a process to generate those insights on behalf of our members, eg:

- *supplier setup* – in this sub-process the 1999 research revealed that companies who actively manage their supplier database have fewer 'downstream' problems (eg Purchasing manages all new vendor additions to the database, and the database is scrubbed regularly). It was surprising how large the opportunity was for many companies to improve overall performance by paying more attention to this critical process input area. Many of the practice leaders have rigorous naming conventions, utilise recognised identifiers like a Dun & Bradstreet Number, and track parent/child relationships, to manage the overall integrity of their supplier database; and
- *discrepancy resolution* – it is common knowledge that in this sub-process it is processing exceptions that have the largest impact on process effectiveness. Practice leaders have clearly defined processes for problem resolution, eliminating the finger pointing that may otherwise occur between the buyer and a Payables processor. Some, recognising that price differences are almost always 'approved' by the buyer, have raised the 'before payment' discrepancy limits where approval is required from £65 to £1,300 or more. To maintain controls on these transactions, the buyer receives an automated report for possible follow-up for adjustment to a future payment. This process change eliminates the bottleneck created to resolve price change discrepancies, improving payables processing productivity.

The payoff for developing this level of insight was made clear to us by the relative progress of companies joining in the A/P best practice research for a period of three years. Their progress, shown in the chart (*left*), was three times the progress of the average participant over the three years.

For more information on Gunn Partners telephone 001 617 747 5090, or visit the web site at www.gunnpartners.com

COMMENT

'Gen e' and the high cost of training

Jeff Wooller does not agree with last month's article by Stuart Crainer on the new 'e' generation – in particular, with Crainer's assertion that 'it pays to have an education'.

Dr Jeff Wooller is principal of Jeff Wooller College and compliance partner with E C Brown Batts & Co.

I take issue with Stuart Crainer whose article – Defining the new 'e'-generation – appeared in May. He states that, more than ever before, education equals money.

In support of his argument he quotes from a 1995 study by the National Centre of the Educational Quality of the Workforce which looked at 3,100 US workplaces:

> *The research found that an average 10% increase in the workforce's educational level led to a 8.6% increase in productivity. In contrast, a 10% increase in plant and equipment increased productivity by 3.4%. In the new company, it pays to have an education.*

He does not attempt to tell us what was the cost of the 10% increase in the educational level or the value of the 8.6% increase in productivity. Neither does he tell us the cost of a 10% increase in plant and equipment.

Not knowing these costs casts doubts on the merits of his conclusion that 'in the new economy it pays to have an education'. He also seems to believe that if education pays in the US that it must apply in the UK, which is a doubtful premise.

I remember a previous article in *Finance & Management* which showed that it is not cost effective in the UK to spend on training. It is much more profitable to pick off workers who someone else has trained. Many of the captains of industry have been trained by the Big Five at great expense.

The training practices spend a small fortune on the education of their trainees, many of whom give notice (as I did) on the Monday following release of the results.

The failure of the TOPPS scheme for training chartered accountants in industry has been largely related to the cost and the amount of time off that trainees require. As well as being concerned about the threat from the Scottish Institute, the English Institute should also be aware of the popularity of ACCA and CIMA in industry and commerce.

The question that the English Institute should be addressing is how to cut training time and costs even further. My own solution is to cut tax out of the syllabus and treat it as a separate profession. Let those who wish to specialise in tax take the ATTI examinations. Let's face it – after each budget, all we learned about tax gets overtaken by events!

You can send your abuse to me on jeffwooller@aol.com but if you have constructive criticism or positive feedback please send to chris.jackson@icaew.co.uk !

LECTURE

Competing in the new economy

In his recent faculty lecture, **David Asch**, Professor of Management at the Open University Business School, reviewed developments in the new internet economy.

Professor Asch warned that not all the portents of the 'new economy' are necessarily good. The television industry, for example, has seen a huge convergence of technology, resulting in a proliferation of channels, yet is still not sure whether viewer loyalty is to channels or types of programme.

To judge the effects of the internet, Asch advised, requires analysis of the basic principles underlying any commercial transaction. For this, he used a classification, based on consumers' ability to distinguish between three categories of properties relating to good and services:

1. search qualities – attributes that can be determined before buying (eg colour, style, price);
2. experience qualities – where the quality of the benefits are only evident after purchase or on consumption, eg holidays; and
3. credence qualities – impossible to evaluate fully, even after buying and/or consumption, eg professional advice, medical care.

Figure 1 (*page 8*) illustrates where the different types of goods or services, high in one or other of these three qualities, lie on a continuum from 'easy to evaluate' to 'difficult to evaluate'. And as Asch noted, since services cannot be displayed, are not entirely uniform in quality, and are themselves affected by the participation of the purchaser, they have few 'search' and many 'experience' qualities.

Next, Asch dealt with how to link these evaluations – and their ease or difficulty – with the consumer's response. For this, it is important to 'get behind' consumers' response to cues about quality and price.

Different evaluation techniques

One of the key things to recognise, Asch remarked, is that consumers use different evaluation techniques for purchases rich in experience and credence qualities than for those with high search qualities. This distinction – rather than the more traditional assumption that purchasing behaviour depends on whether the item is of a goods or services nature – is the real differentiator.

FIGURE 1 EVALUATING GOODS AND SERVICES

Customer involvement			
HIGH	Jewellery Furniture	Child care Holidays Restaurant meals Domestic appliances	Medical diagnosis Professional services Financial services (eg a mortgage)
LOW	Clothing	Groceries	Financial services (eg credit cards)
	High in search qualities	High in experience qualities	High in credence qualities
	Easy to evaluate		*Difficult to evaluate*

Hence, when the buyer is both particularly involved in the purchase (as with something expensive, bought infrequently, risky, and expressive of their taste), and aware of considerable differences between brands, the decision-making process is particularly complex. A cognitive learning process takes place, involving the development of beliefs and attitudes about the product before finally concentrating on the product itself and making a choice.

However, given the same high involvement but where the product shows little difference between brands, the consumer will shop around and then purchase quite quickly.

For the many products bought with low involvement and showing little brand differentiation – eg sugar – the purchasing decision is a simple matter of picking the product up in a shop.

And the process differs again where the purchase is one of low involvement but considerable brand differentiation, in which case much brand switching may occur – eg when buying biscuits.

Developing a framework

To establish the framework of customer decision making, the two dimensions so far discussed – ease of evaluation, and the way in which consumer decisions are made – can be plotted together, as in Figure 1.

Looking, next, at the list of the top ten internet shopping categories, one can see just what sort of product – and type of decision-making process – score highly in internet sales. The 'Top Ten' – PC hardware, travel, entertainment, books/music, gifts/flowers, clothes/footwear, food/beverages, jewellery, sporting goods, consumer electronics – are almost equally divided between purchases involving high and low degrees of consumer involvement in the decision-making process, while purchases high in credence qualities are conspicuous by their absence (possibly, Asch surmised, because these require more information about their qualitative nature than the internet currently provides).

However, Asch said, popularity does not necessarily mean commercial success – books and music may be number four on the list, but Amazon.com is still not making a profit.

Impact of the internet

Asch quoted various statistics for internet usage and impact. Those showing actual (1999) and projected (2005) households on-line in countries around the world indicate an overall expected rise of 150% in European penetration over the period (including UK on-line households rising from 4.7 million to 12.6 million), much less in percentage terms in the presumably already more 'wired' US (44.7 million households rising to 72.1 million).

His data for households that have shopped on-line show that even in the US – with the highest percentage – the proportion of on-line households shopping on the internet is only 50%.

His figures for the demographics of on-line buyers indicate the typical purchaser to be quite mature (35 to 42 years), with average household income of between a $65,000 high (UK) and a low of $36,000 (Italy). A large proportion are graduates.

The implications

The speed of change in technology makes it difficult to assess the implications of the internet as yet. The recent explosive growth in the use of the Net for business to consumer (B2C) and business to business (B2B) transactions, has been primarily based on use of PCs and communications networks, but what will be the effect of television and mobile phone access, particularly on B2C?

As Asch pointed out, a 1998 article in the Harvard Business Review, suggesting four possible business opportunities arising from use of the Net, has proved surprisingly accurate. The four possibilities – forging direct links to customers; bypassing competitors in the value chain; using the internet to deliver and develop products and services for new clients; and becoming the dominant player in the digital channel of a given industry – are now being employed by the likes of Dell Computers, Sony and Intel.

In regard to direct links, Dell has used technology-based distribution strategies and leveraged relationships with suppliers and customers to such an extent that they are now virtually integrated. Sony is using the third strategy, moving beyond the existing range of its activities to offer internet banking to new customers. (with the possible knock on benefits of raising its profile as an internet company and increasing its networking potential). A similar move into new areas would seem to be that of Intel, leading maker of microchips for PCs, now starting to attempt the manufacture and supply of consumer products – an effort both to offer new products to new customers and to bypass rivals in the value chain.

However, despite such examples, by far the largest number and value of transactions taking place through the net are B2B rather than B2C.

Conclusion

Asch concluded we can be fairly certain that the rate of change of information and communications technology (ICT), and the ability of firms and individuals to access it, will change the way goods and services are marketed and delivered.

He predicted that to compete effectively, firms are now going to have to develop sophisticated global supply chains and logistics capabilities to manage their networks. They will also have to grapple with issues such as centralisation/decentralisation (weighing common ICT systems and global sourcing and supply chains against fragmenting consumer choice)

He also suggested that an accompanying increase in the trend to try and influence consumer preferences may lead to an upsurge in intermediaries (or, as he put it, 'infomediaries'), in response to the need for objective assessments of the search and experience qualities of the goods being sold on the net.

David Asch is Professor of Management at the Open University Business School. His latest book 'New Economy – New Competition' will be published this year.

STRATEGY **UPDATE**

Bear market – threat and opportunity

In this strategy update column **Chris Hughes-Rees** looks at the threats and opportunities presented by the recent bearish market conditions, suggesting ways to maintain a flexible strategy and hence the ability to respond proactively.

Present market conditions have not been experienced for a number of years, and the current mixed views and statistics make reliable prediction of the degree and length of the downturn an almost impossible task.

The big challenge is to turn present conditions to advantage and tweak strategies accordingly. In my previous update column, I talked about trying to handle the volatile Technology, Media and Telecoms (TMT) market conditions. But these conditions are now also hitting the 'old economy' very hard and there are business fundamentals at risk, not just share prices. The following are my recommendations for damage limitation.

Re-assess the future and the depth of downturn

These market conditions require astute judgement. Unless immersed in some extensive strategic effort right now, I suggest you re-think and make no apology for being blunt about it. I have already mentioned the mixture of views about the depth and duration of the downturn, but your own business 'intelligence' activities will tell you what is happening to your customers, suppliers, competitors and business partners – and it is unlikely to be in line with your predictions of a year ago. For example:

- *customers* – your order book is the big indicator and it may already have taken some (possibly savage) hits. The task is to quantify the likelihood of further impact. You may also be faced with a potential reshape of your markets. Some of your customer market segments may be relatively intact; if so, consider a short-term shift of emphasis, if you have the flexibility;
- *suppliers* – make sure that your suppliers aren't about to do something dramatic that could wipe out part of your production. They may well have their own significant problems, so make sure you are not the last to know. Work with them co-operatively, not against them;
- *total supply chain* – the 'end to end' components of the supply chain are numerous. Talking about customers and suppliers are two key elements but make sure that you are aware of the stresses and consequent threats posed by other factors such as logistics providers who are also wrapped up in the economic volatility;
- *competitors* – how are they faring? Understand what has hit them and also what they are doing to mitigate the damage. They may be struggling in some market segments or even forced to withdraw. If so, this may provide short and long term tactical opportunities.
- *partners* – alliance and outsource partners are an integral part of business life. Ensure that these relationships are being managed proactively and be aware that any 'get out' clauses within them may now be a near term threat. Again, the key is to manage the relationship tactically and not just financially.

Batten down the hatches – within reason

The bottom line and the growth trend must be kept intact as much as possible. Yes, accept some deterioration in forecasts, but ensure that the mid and long term strategy is robust and has a high confidence level. Yes, the cost base of the business must always be astutely managed, but don't let the business's best expertise and know-how walk out of the door – starving its future growth and resource base. Markets tend to sympathise with the credible mid and long term story more than the short term 'slash and burn' which smacks of reactive panic.

Be bold and buy – but don't bet the farm

One huge opportunity that these volatile market conditions bring is that rare chance to buy a target company or division at a bargain price. This is not straightforward – possibly one's own depressed stock price and reduced cash flow making the deal harder to pull together. But the key is to be seen to be bailing out the target company's shareholders (without an overly generous premium) while reinforcing one's own shareholders' belief in their company's management capability and strategy.

Chris Hughes-Rees is an independent strategy and business change consultant. Tel: 01628 528969 or email: chr@strategic-process.com

MANAGEMENT ACCOUNTING **UPDATE**

The axeman cometh...

John Fanning of KPMG Consulting identifies some factors to consider when identifying and implementing potential cost reductions.

The economic downturn in the US now seems to be spreading and many financial professionals will be trying to identify cost savings. So which areas offer the greatest potential for savings?

Setting the cost baseline

The current cost structure must be understood and an accurate and detailed assessment 'baseline' be established. Ideally this baseline should be constructed using activity-based approaches*, as these provide far more insight into the cost base and improvement opportunities than more functionally based analysis.

Identifying cost reduction opportunities

It is important the organisation understands the extent to which it can influence its overall cost structure and the size and nature of the cost savings available. Costs should therefore be considered at one of three levels:

- *structural level costs* – at the highest level are structural costs, common to all participants in a given sector and macro-economic in nature. They are driven by factors such as scale and scope economies, input costs, and technology choices. Changes in the cost structure of industries at this level are rare but yield huge reductions if identified. For instance, significant input cost reductions result from transferring from high-cost to low-cost countries, eg making trainers in Vietnam not the US etc;
- *tactical level costs* – these provide a more fruitful source of cost reduction opportunities because they are determined by choices the organisation makes rather than by industry wide macro economic factors. Savings here might involve providing a very limited cabin service but slow flight process (low cost airlines); getting customers to clear tables after themselves rather than providing this service (fast food bars); or using call centres to provide after sales service rather than a mobile sales force (call centres being cheaper and more immediate); and
- *operational level costs* – these support the core value proposition or are necessarily incurred by virtue of being in business, eg administrative costs. Unlike tactical level costs they have little impact on other parts of the business as a whole and, once identified, they can usually be implemented quite quickly. Examples or potential savings here include reducing HR costs by moving towards web enabled employee self service (they change their own personal details on screen rather than completing a form for HR to process); moving all processing tasks into a shared service centre; or outsourcing them.

Delivering the benefits

What factors are crucial to a cost reduction project's success? First, objectives should be quantified and progress against them tracked.

Secondly the analysis should employ external benchmarks if possible (the internet is a source of information, while commercial data providers can supply statistics and key ratios for different industry and functional areas). Thirdly there must be demonstrable executive commitment to the process.

Finally the exercise must not conflict with the strategic goals and objectives of the business.

John Fanning is a consultant with KPMG Consulting. He can be contacted on 0131 527 6717 or by email at john.fanning@kpmg.co.uk

**See* Good Practice Guideline, *issue 23.*

FORTHCOMING FACULTY EVENTS – 2001

To attend any Faculty event, please fill out the form which adjoins this page, remove it by tearing along the perforation, and mail it or fax it to Jacquie Lee at the Faculty's address given on the bottom of the form. If you have any queries relating to these or other events please contact Jacquie Lee on 020 8953 0758.

- 13 June
HALF DAY WORKSHOP & AGM (Chartered Accountants' Hall, London)

'POST ACQUISITION IN CONTEXT – DELIVERING ON THE DEAL!' WORKSHOP – MARY MOORE AND IAN SHORTLAND OF BUSINESS LEARNING PARTNERSHIP.

A 1996 survey found that, although European and Asian managers scored highly on pre-bid skills, they scored worst in the planning and execution of the integration. This programme will look at: an overview of the merger and acquisition process; the consequences of not getting it right; post-acquisition in context; group case study; an example of successful integration; and the questions to ask. The workshop will be followed by the Faculty of Finance's AGM. Registration 9.30am; workshop sessions 10.00am-12.30pm; AGM 12.30pm-12.45pm; buffet lunch 12.45pm-2.00pm. (Places are limited)

- 3 July
EVENING LECTURE (Chartered Accountants' Hall, London)

'INTELLECTUAL CAPITAL – THE BASIS FOR SHAREHOLDER VALUE: MEASUREMENT AND VALUATION ISSUES' – GÖRAN ROOS, CHAIRMAN OF INTELLECTUAL CAPITAL SERVICES (ICS) LTD AND VISITING PROFESSOR AT THE HELSINKI SCHOOL OF ECONOMICS AND JOE PEPPARD, SENIOR RESEARCH FELLOW, CRANFIELD SCHOOL OF MANAGEMENT.

The purpose is to familiarise delegates with issues and methodologies relating to intangible resources (or 'intellectual capital') with emphasis on linking strategy, intellectual capital, business logic, cost drivers, value drivers and revenue with market valuation. The main presentation will focus on introducing concepts as methodologies and there will be some case studies. Registration and coffee 5.45pm; lectures with case studies 6.00pm; and buffet and networking 7.30pm-8.30pm.

- 18 September
EVENING LECTURE (Chartered Accountants' Hall, London)

'THE BALANCED SCORECARD' – ROBIN BELLIS-JONES, MANAGING DIRECTOR, BELLIS-JONES, HILL & PRODACAPO LIMITED.

The balanced scorecard has established itself as a definitive management tool of the 21st century enabling the vision of a strategy-focused organisation to become a reality. The lecture will begin with a short introduction, moving on to discuss implementation issues and then concentrating on maintaining momentum and the areas of difficulty commonly encountered. Registration 5.45pm; lecture 6.00pm; buffet and networking 7.00pm.

- 25 October
ONE DAY CONFERENCE (Chartered Accountants' Hall, London)

'SHAREHOLDER VALUE – FROM MEASUREMENT TO MANAGEMENT ' – SPEAKERS FROM EV LTD, ATC, MARCONI, CADBURY SCHWEPPES PLC, BAE SYSTEMS, KEPLER ASSOCIATES, AND VALUE PARTNERSHIP LTD.

This conference considers both the 'measurement' as well as broader aspects related to the 'management' of value creation. Specifically the conference will cover issues such as: understanding the investors' perspective on value creation; identifying appropriate performance measures to guide value creation; using software tools to support value creation; and understanding and overcoming the implementation challenges inherent in 'managing for value'. Registration 9.00am; conference 9.30am-4.25pm.

RECORDINGS OF FACULTY LECTURES

Recordings of the London lectures are available, in both **audio** and **video** format. To obtain a recording, please tick the audio and/or video box on the tear-off response form opposite.
There is a charge of £5.00 for audio recordings and £10.00 for video.

THIS MONTH

DYNAMIC STRATEGY – CREATING SHAREHOLDER VALUE THROUGH STAKEHOLDER MANAGEMENT
Mark Thomas of PA Consulting Group illustrates how companies which adopt this approach obtain superior returns.

Businesses behaving badly...

Robert Bruce describes the growing view that companies need to make social responsibility a higher priority. He argues that, even if not measurable in terms of performance, improved social responsibility can enhance a company, its brand and reputation.

Robert Bruce is accountancy editor of The Times.

For a generation, people have striven to create what they see as morally responsible companies. There is the 'Tomorrow's Company' initiative. There was the great move towards simplified reporting for employees and stakeholders. The whole range of corporate governance reforms embodied in the Cadbury, Hampel and Turnbull reports were based on the premise that a company which behaved well also performed well. There has been expansion in ethical investment.

But until now these initiatives have always foundered on one irritating rock: it is very difficult to measure how much better a company 'well-behaved' in this context has performed against those more Neanderthal in their attitudes. There are no really effective performance measurement criteria for the job.

Behaviour

But it is increasingly obvious that companies need to get up to speed in this area. The current concept of corporate behaviour is under attack and to dismiss this as a few mindless crazies having their say is to miss the point. People in the mainstream all around the world are increasingly uncomfortable about corporate behaviour, not just a fringe bunch of anarchist firebrands.

It is in this context that a recent research report on the concept of corporate social responsibility should be seen. It was produced by PricewaterhouseCoopers on behalf of the Industry and Parliament Trust, a charity which tries to bridge the gap in understanding between industry and Parliament. The survey reveals what MPs think about these issues and provides commentary from senior people in Parliament and industry.

Relations between Parliament and business are always fraught. Business believes that it is misunderstood by politicians and politicians view business as a double-edged sword. Business success brings prosperity to the land and ministers love to bask in the glory that brings to the economy; but they also know that business disasters will bring instant criticism of their ministerial performance. They are chary of being seen as too close to the business action. So politicians both love and loathe business.

You can see some of this ambivalent attitude seeping through between the lines of the report. For example one finding, that '44% of MPs surveyed think that global companies now have more power than government,' suggests the relationship is already off on the wrong foot. And not surprisingly, given that politicians prefer to deal in ideals rather than pragmatic realities, they think that business is not paying enough attention to the concept of corporate social responsibility. A whacking 80% of them believe companies' current practice in the area fails to meet society's demands.

Overhead

David Heathcoat-Amery, a onetime merchant banker and Treasury minister, encapsulates one view of the idea. Corporate social responsibility, he says, is "a sort of social overhead". Simon Hughes, the Liberal Democrat MP is rather more optimistic, feeling that it "wins orders, wins customers and wins allies". And that probably is the real point. Business needs allies.

Business must see that corporate social responsibility is connected with their brand and their reputation. Neither is easily measured. But people know when they have got them right. Sir John Bond, chairman at HSBC Holdings, sums it up: "Increasingly clients are beginning to decide that they want to do business with companies which behave responsibly".

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