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Faculty of Finance
and Management

Finance & Management

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A new approach to management information

Robert Bittlestone
on creative ways to
budget, forecast
and control

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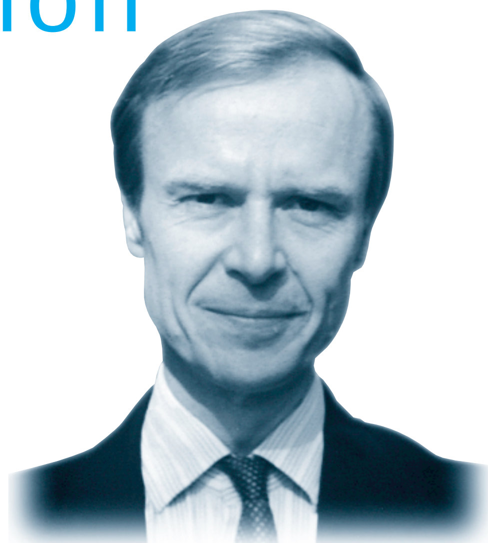

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The renaissance of private companies

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Faculty faces

Main contact numbers
Tel: 020 7920 8486
Fax: 020 7920 8784
Web site:
www.icaew.co.uk/members

Chris Jackson
(Head of Faculty)
Extn: 8525; Email:
Chris.Jackson@icaew.co.uk

Jacqui Newell
(Services manager)
Extn: 8508; Email:
Jacqui.Newell@icaew.co.uk
(Maternity leave)

Judith Shackleton
(Technical manager)
Extn: 8426; Email:
Judith.Shackleton@icaew.co.uk

Debbie Came
(Administrator)
Extn: 8486; Email:
Debbie.Came@icaew.co.uk

Maria Carlstrom
(Administrator – on maternity leave)
Maria.Carlstrom@icaew.co.uk

FINANCE & MANAGEMENT is edited and produced on behalf of the Faculty by Silverdart Ltd, Unit 211, Linton House, 164-180 Union Street, London SE1 0LH. Tel: 020 7928 7770, fax: 020 7928 7780, contact: Alex Murray, Gabrielle Liggett or Helen Fearnley.

Corporate information on the web

The following web sites may be useful sources of company data:

BIRD Online – Business information web site accredited by the Enterprise Zone providing a range of useful web and business directories including general business information, industry specific information and business opportunities.
www.bird-online.co.uk

Zephus Corporate Finance Knowledge – mergers and acquisitions database, with details of European deal activity since 1997 (including the UK from January 1999). The database can be searched on a range of fields such as company, industries, deal types, target activity and country – with a high degree of customisation possible. Deal records give a summary of the acquisition, whilst cross references give further information on the target, the bidder, and any parent company. The site also includes an option to subscribe to deal information by email.
www.zephus.com

Going Public – web site listing new UK share issues made by way of prospectus, with a focus on AIM and OFEX markets. The listing details offer open/closing dates along with the offer price – with further detail available on each company. Company entries include market captalisation, funds to be raised, and a direct link to the full text of the company prospectus.
www.goingpublic.co.uk

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

ABSTRACTS FROM LIBCAT

Arnold GC et al – The theory-practice gap in capital budgeting

Journal of Business Finance and Accounting, Vol.27. No.5/6. June/July 2000: p603-626 (24 pages)

● *The authors report the results of a survey of capital budgeting techniques used by UK firms. Where possible, the evidence is combined with data collected over a 22 year period to provide a basis for the discussion of causes of trends. The authors observe that there has been a substantial narrowing of the theory-practice gap in the use of project appraisal methods. The gap has also narrowed in other areas: the analysis of risk, inflation adjustment, capital budget preparation, WACC calculation and post-auditing. However, there are other elements of capital budgeting theory, eg probability and beta analysis, which have been adopted by very few practising managers. The authors also discuss non-economic projects, capital rationing and hurdle rates.*

Arthur A – How to build your own project budget model...

Management Accounting (CIMA), Vol.78. No.4. April 2000: p20-22 (3 pages)

● *Despite similar concerns with resource measurement and scheduling, project planners and accountants don't really see the world in the same way. Project managers and planners tend to think in terms of tasks, task costs and planning-based forecasts, while accountants tend to think in terms of time periods and cost types. The author suggests the gap between the two can be bridged by using a budget model that can be built using a spreadsheet. The first step towards creating a project budget model is to divide the project up into 'cost relevant' tasks. The project plan will be based on tasks that the project manager and planner have decided are operationally relevant. The author looks at the constructing of the model and at how the model should be used.*

http://www.icaew.co.uk/library.htm

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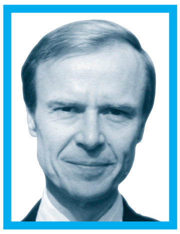
The 'clever toys' approach to multinational management

Robert Bittlestone, managing director of research-based consultancy Metapraxis, proposes an imaginative new system of budgeting, forecasting and multinational management control.



Baffling title? True, but let us reflect for a moment on those wonderful toys that informed our children's education. I am thinking here about bright colours, personal involvement, a vivid sense of excitement and purpose combined with the power to generate lasting insight. Children's toy manufacturers may not know how to price options, for example, but they clearly know a thing or two about learning and communication in young human beings.

As we grow older, our games evidently become more sophisticated. Multinational managers no longer assemble colour-coded plastic components; they juggle with business elements of a rather different kind. These atoms are multi-dimensional: their locus is the volume described by a Rubik cube. One edge of the cube corresponds to the set of our subsidiaries. Another corresponds to our performance indicators, such as sales, profit, market share and cash flow. A third edge represents consecutive monthly management accounting periods, stretching from the past into the future. When we make a statement such as 'Sales for Latin America were £45 million in June' we are describing a particular value within this cube, defined by its three edge coordinates.

Multiple dimensions

In principle a brightly-coloured cube could be helpful as a physical model for multinational management, but unfortunately we need to incorporate further dimensions. Imagine a whole line of such cubes, the first labelled 'Actual', the second 'Budget', the third 'Forecast' and so on. Collectively they define alternative corporate realities: other worlds in which we might live if only we knew how to achieve the transition.

Once we allow ourselves this fourth dimension, further complexities press their claims. Sooner or later, we are obliged to acknowledge five-dimensional armadas of cubes named 'fixed exchange rate', 'latest exchange rate' and other monetary distinctions. We also find the need to recognise six-dimensional flotillas of cubes called 'product A, B & C'. Worse, we must further distinguish between seven-dimensional data transformations such as 'single period', 'year to date', 'moving annual total' and so on. And we haven't yet considered additional distinctions such as major global customers or alternative distribution channels.

This is the complex stuff of multinational reality, and we should not be surprised to learn that when routine tasks such as monthly management control or short-term forecasting or annual budgeting (which equates to creating simulated data values within the fourth of the above dimensions) arise, most head office finance teams tend to resort to a technique which I will term 'vertical control'. This involves two simplifying techniques: delegation and consolidation.

Vertical control

Instead of trying to create a model of the interactions between the key performance indicators of the whole group (such as the impact of market share on the company's share price), the crucial task of figuring out these cause and effect relationships is often delegated to the operating divisions. They in turn delegate it to their subsidiaries, who use their own idiosyncratic, local approach to come up with a budget or a forecast. The consolidation system then adds these individual schedules vertically up the corporate structure to create 'the budget' or 'the forecast' for the whole group.

This outcome is hardly a living, breathing model of what the overall business is capable of achieving in the future. It is a frozen set of numbers with no hint of the underlying cause and effect relationships that produced them. By now we are missing any sense of excitement or purpose, nor do we detect in our budgets and forecasts the power to generate lasting insight. Far from an adult version of an educational game, these vertical budgets are stupefyingly boring.

Consider the maxim 'Boring information doesn't change management behaviour': if true, it follows that accountants' obligation to make their diagnoses interesting is no longer optional, but mandatory. How, then, can we make the task of budgeting, forecasting and multinational management control intrinsically interesting?

Tabular reporting

My primary advice is to make the cause-and-effect relationships visual. Qualified accountants are perfectly familiar with the factors that drive a profit and loss account, balance sheet and corporate cash flow. Why not therefore spell these out?

Tabular depictions can mislead. Consider the standard accounting tabulation in Figure 1 (*below*), and try using it to explain to a non-accountant how to increase operating profit and cash flow.

It is obvious from the left hand table that profit will increase if cost of sales decreases. It is equally obvious from the right hand table that cash flow will increase if depreciation increases. Whoops... some of us know that that's not true. In fact, as far as cause and effect relationships are concerned, the conventional cash flow table is positively deceptive.

Horizontal control

If you believe that it is important for all the members of the management team to understand what's really happening, then you'll need to adopt a quite different approach. And over the last 10 years I have found that the following approach generally works rather well for intelligent, non-financially qualified line managers:

In Figures 2, 3, 4 and 5 (*diagram on opposite page*), the dark coloured boxes are internal drivers – in other words, they represent decisions that need to be made by the management team. The white boxes are external drivers representing assumptions that we can anticipate but not control. The light coloured boxes are interim outcomes – they emerge as calculated results from the drivers. Finally, the grey boxes are objectives – values that we are trying to maximise. Also, a straight arrow represents positive causation, while a zig zag arrow represents negative causation.

So Figure 2 (*white area, top left in the diagram*) simply depicts profit and loss arithmetic in diagrammatic form. This example is indicative of typical practice in a manufacturing company, but you can use the same notation to set out comparable relationships for any business.

FIGURE 1 STANDARD ACCOUNTING TABULATION

P&L account	£,000
Sales	1,500
– cost of sales	– 900
= Gross profit	600
– expenses	– 400
= operating profit	200

Cash flow analysis	£,000
Operating profit	200
+ depreciation	+ 100
– increase in working capital	– 500
– capital expenditure	– 200
= operating cash flow	– 400

Balance sheet drivers

Most line managers are fairly comfortable with P&L accounts, but their level of discomfort increases when faced with the balance sheet. In the business driver diagram (Figure 3, *white area, bottom left in the diagram*) I have focused on the operational side of the balance sheet where the capital is deployed rather than where it came from because this generally corresponds more closely to items that line managers can personally control:

Figure 3 uses the same conventions for the boxes and arrows as in the P&L version. It highlights the variables that managers can control and simply depicts the outcome of those decisions.

Cash flow & EVA®

As it stands, Figure 3 doesn't state an objective for balance sheet management, but we can easily remedy that:

Figure 4 (*at right, inside unbroken border*) may require the practising accountant to spend a little more time in line management explanation than did the previous two, but your management team will by now be learning rapidly from these depictions.

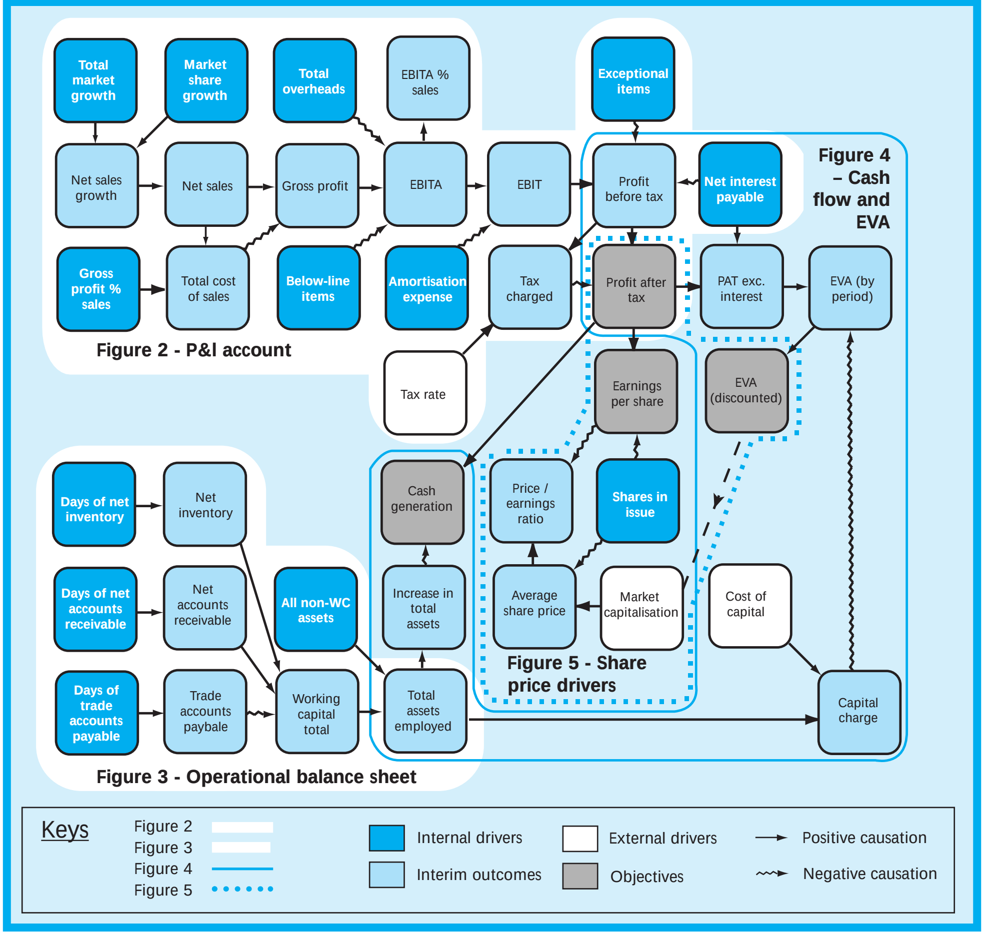
First of all, Figure 4 indicates that cash generation is increased by a higher profit level, but decreased if the asset base increases. So if cash generation is one of your objectives, as the diagram suggests, then the diagram makes it clear to line managers that they should keep their asset base low.

Secondly, the diagram proposes a simple explanation for 'Economic value added', as follows. The assets employed have been funded by investors who could have put their money elsewhere. The capital charge therefore represents the return on this investment that reasonable investors (both shareholders and banks) would expect to make on an investment of this level of risk. In economic terms, this is simply the opportunity cost of tying up one's capital in this business.

So was it a good idea to invest in this business? Well, the company is making the indicated profit (after tax but excluding interest, since we are already allowing for that in the cost of capital). If that profit is greater than the capital charge in a given period, then the business is adding value and it was indeed a good idea to invest in it, because the return exceeds the market rate for an investment of this level of risk. If however the profit is less than the capital charge, then the business is destroying value, because the investors' return is below the market rate.

That's just about it except that we should also recognise that the overall economic value added is best represented by calculating the present value of the expected stream of future individual period figures for value added. We need to look at the expected values for the next few years as a whole.

FIGURE 2, 3, 4 and 5 BUSINESS DRIVER ANALYSIS – THE OVERALL PICTURE



Share price and market capitalisation

Your managers may now be asking you the $64,000 question: 'Which of these measures affects the price of our shares?' Fortunately it turns out that we can easily depict the impact on the share price. Part of this is simple arithmetic and the other part represents a market theory.

In Figure 5 (*centre right, inside dotted border*), the simple arithmetic is that if you determine the number of shares in issue, and if you know what your market capitalisation is at any point, then clearly you can rather trivially calculate key data such as your earnings per share, your average share price and your P/E ratio. However, this begs the question of what affects your market capitalisation in the first place.

If you believe in EVA then the proposition is that the most reliable predictor of market capitalisation is discounted EVA. In other words, it is proposed that rational investors attempt to form a view about the expected future stream of a company's value added (ie the premium over the cost of capital for this class of investment) and this determines the extent to which they value the company today. This article is not the place to discuss whether this is the most accurate predictor available for market capitalisation, but what we can easily do is to incorporate the theory into Figure 5, as depicted by the dotted line arrow. The theory then becomes (a) understandable and (b) testable.

The overall picture

Now that we have taken the management team through each individual aspect of the accountant's view of the world, it is time to take a deep breath and put it all together.

At this point you may be understandably concerned that your line managers are not going to relate to this diagram – that they will simply opt out of the debate entirely. However, experience suggests that this may not be as much of a problem as you might fear. Most line managers are profoundly grateful to financial professionals for their genuine attempts to explain the rules of corporate engagement. After all, engineers who are familiar with plant layouts or circuit diagrams will hardly be daunted by a diagram of this relative simplicity, and neither will research chemists, logistics experts and many other management professionals.

Non-financial objectives and balanced scorecards

A business driver diagram of this nature unifies the efforts of a management team by articulating a coherent statement of 'Why are we here and what are we trying to achieve?'

Here it should be noted that nothing in the technique obliges a company to choose EVA or indeed profit as a specific objective: indeed one might reasonably assume that Railtrack's 'business driver diagram' contains a critical objective called 'safety'.

Likewise, the business driver diagram does not need to start as far down the food chain as 'total market growth'. To the extent that consumer interactions such as customer satisfaction can be measured and their impact on market share analysed, there is no reason why the business driver diagram approach cannot model the interactions and linkages between performance measures that otherwise tend to be presented in isolation as elements of a balanced scorecard or similar project.

Conclusion: Back to playtime

Once you make the effort to establish a simple regime of cause and effect diagrams as a basis for communicating performance information with your management team, the same approach can then be used for a whole continuum of executive tasks, ranging from historical performance management, current period monitoring, short term forecasting, annual budgeting and also strategic planning.

The technique also lends itself effectively to computerised information provision, in which the business driver diagram becomes a powerful interactive 'what-if?' framework for evaluating alternative corporate budgets and strategies.

In summary, significant performance improvements occur when all the executive team members are actively and co-operatively engaged This is particularly true when they are playing with a model which conveys a sense of excitement, purpose and personal involvement combined with the power to generate lasting insight. If you don't believe me, ask your children for their opinion.

Robert Bittlestone is managing director of Metapraxis Ltd, a research-based consultancy and software group focusing on corporate planning and control since 1985 (www.metapraxis.com).

Readers may also like to refer to 'The value reporting revolution: moving beyond the earnings game' (Eccles et al, 2001 – John Wiley & Sons Inc, $29.95).

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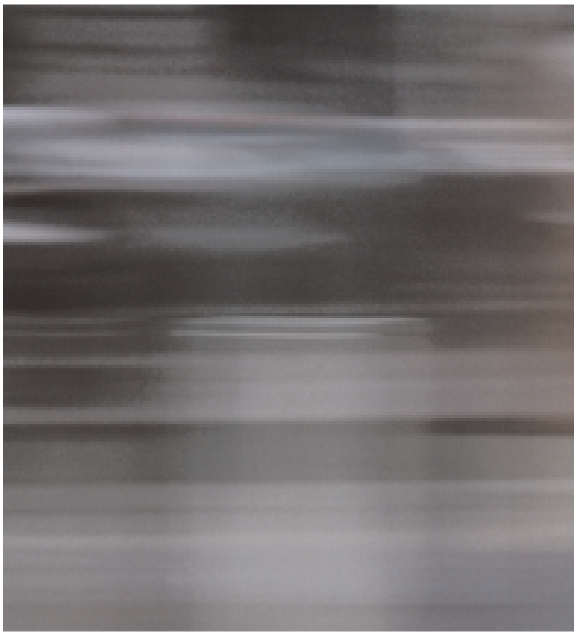
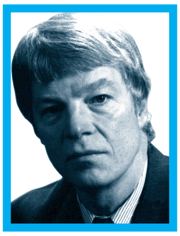
Beyond budgeting – the barrier-breakers



Jeremy Hope (*left*) and **Robin Fraser** explain why budgeting is a barrier, how the CAM-I Beyond Budgeting Round Table has been studying companies that have abandoned budgeting, and who the barrier-breakers are.



There are many people who will tell you how to transform your organisation. Most will present compelling evidence that aligning measures with strategy, implementing quality management, reengineering processes, entering into strategic partnerships, and a host of other approaches, will be just what your organisation needs.

There are broadly two schools of thought about organisation transformation. First, there is the mechanistic school that sees the organisation as a machine that just needs overhauling and tuning. Its solutions include balanced scorecards, economic value-added, activity-based management, and enterprise-wide IT systems. Secondly, there is the human relations school that sees the organisation as a complex set of inter-relationships that just requires the right leadership to release the untapped potential of human capital. They promote solutions such as quality, team-working, empowerment, and knowledge management. Though both schools believe they have all the answers, the reality is that each reflects its own functional view of organisational problems and solutions — an approach largely mirrored by the consulting community. But as most people know, the fundamental truth is that the management model is indivisible.

The holistic approach

What is required is a holistic approach. That is what we have been

searching for, and that is what has made our research different. We contrast the management practices used in the industrial age (referred to as the budgeting model) with those that are now required for the information age (the beyond budgeting model).

Beyond budgeting

Why 'beyond budgeting'? If you were to choose one word that was representative of industrial age management, then we reckon budget would be hard to beat. It conjures up a physical world dominated by mass production, manufacturing plants, assembly lines, and arcane product costing systems, in which organisations were neatly divided into product groups, functions, divisions, and departments. People were defined by their position on the organisation chart and layers of supervisors controlled armies of blue-collar workers. It was a world of order and efficiency with clearly defined markets filled with known competitors, physical supply chains, and predictable customers. And it was a world in which accountants could model cause-and-effect relationships between volumes, costs, and profits – confident in the outcome of their forecasts.

For most companies today, however, that world is a fading memory. Increasing levels of uncertainty and more demanding customers have changed the business landscape, and in this environment the budgeting model is a real handicap. That said, many of its practices remain doggedly familiar. For example, most managers still dance to the tune of fixed plans and annual budgets, just like they did 30 years ago.

To us, the very idea of engaging huge numbers of people in a protracted cycle of detailed planning, and then making them march to the drumbeat of the budget, seems not just a waste of time, but also an insult to their intelligence. Yet almost every organisation does it. It was our belief that this was the hidden barrier to change that persuaded us to form a partnership with international research organisation, CAM-I, and establish the Beyond Budgeting Round Table (BBRT).

Since its inception in January 1998, 55 (mostly large European) companies have participated in the BBRT. Though its origins are in the UK, the BBRT now has members from many countries including the UK, Belgium, Holland, France, Germany, Norway, Sweden, Switzerland, South Africa and the US. We have just formed a BBRT regional group in Australia, and expect to do so also in the US in the course of 2001.

All member companies joined the BBRT because they recognised that the budgeting model was increasingly out of kilter with their competitive environment. Despite these concerns, however, few were convinced at the outset that there was a viable solution. Our task was to provide this solution.

Identifying the barrier-breakers

We did this by first identifying the barrier-breakers, those companies that had abandoned the budgeting model. We visited many of them, and through case reports and presentations, reported back to BBRT members. Then, by extracting best practices, we gradually pieced together a coherent set of common principles that formed the framework of what has since become known as the beyond budgeting model.

It has taken a few years for many BBRT members to move from being curious observers to committed implementers. They needed to be convinced by the evidence. We believe that our step-by-step approach to producing a set of principles, then a diagnostic, and finally an implementation guide, provided this evidence and has given them the confidence to proceed.

Of the barrier-breakers we identified, 14 have so far been the subject of visits and case studies by the BBRT. Some of these have succeeded in embedding the beyond budgeting principles into their management processes. Others have had dynamic leaders who have made real progress only for the company to revert back to old ways when new leaders have taken over. Most have resulted in a significant step/change in financial performance that has been sustained over many years.

Our cases are SKF – the world leader in roller bearings, Svenska Handelsbanken – a Swedish universal bank, Borealis – Europe's largest petrochemical producer, Boots – the UK retailer, Volvo Cars – the Swedish car manufacturer (now acquired by Ford), AES – a US-based global power company, Sprint – one of America's oldest telecommunications companies, Carnaud Metal Box – an Anglo-French packaging company, Groupe Bull – often referred to as a European IBM, Fokus Bank – a small Norwegian bank recently acquired by Danske Bank, Alshell – a Swedish building supplies wholesaler, Bulmers – the leader in the UK cider market, CIBA Vision – an eye care company based in the US and a subsidiary of Novartis, and Sight Savers International – a small UK-based charity.

While we reported on these, many others have made real progress toward beyond budgeting even though they still operate with elements of the traditional model. Neither Toyota nor Scania, for example, believes in setting financial targets, yet both companies have uninterrupted profit records going back 40 years.

IKEA, the largest and most profitable furniture retailer in the world abandoned the budgeting model in 1994, and is by far the lowest cost producer in the industry. Its profit margins have rivals gasping.

Cisco, Dell and Alcoa have revolutionised capacity planning by introducing advanced information systems that enable all parts of their extended networks (including suppliers and partners) to respond in real-time to customer requests. The results have been spectacular cost reductions and lower inventories.

General Electric and BP-Amoco have adopted most of the beyond budgeting philosophy and empowered front line managers to make strategic decisions within clear values and boundaries. Jack Welch and John Browne respectively have spent much of their time as leaders in rooting out the budgeting model. Virgin and Enron have been highly successful, operating more as venture capital companies with highly devolved management structures.

In every beyond budgeting case one or two people have had the courage to stand up and challenge conventional wisdom. Dr Jan Wallander at Handelsbanken is perhaps the outstanding candidate for chief barrier-breaker. He is from that rarest of breeds (like another JW, Jack Welch) a real visionary who could see that the way large organisations were being managed was fundamentally flawed. He was the architect of the model that has made Handelsbanken today the most cost efficient bank in Europe. Its shareholders, customers and employees have much to thank him for. After 20 years or more,

'It has taken a few years for many BBRT members to move from being curious observers to committed implementers... '

other Scandinavian companies followed the bank's lead. IKEA, Volvo, Borealis, Fokus Bank, Ahlsell and many others listened to Jan Wallander and liked what they heard.

Another barrier-breaker, Bjartes Bogsnes at Borealis, questioned the need for months of planning and budgeting in a petrochemicals industry in which forecasting was no better than a lottery. He convinced his superiors that a new approach would bring significant benefits. He showed that these initiatives can be successfully driven by finance people. After six years, a new CEO and CFO, and a serious downturn they are still a no budgeting company.

Scandinavia – the pioneer of this new model

It was obvious from the outset that most of the pioneering work on beyond budgeting had been done in Scandinavia. Why Scandinavia? Perhaps because it is a closely-knit business community where imaginative ideas travel quickly; perhaps because its companies are subject to high levels of uncertainty (many of them operate globally); perhaps because financial budgeting conflicts with the notion of intellectual capital – an idea that also had its genesis in Scandinavia. Or perhaps Scandinavian companies are fortunate in having a predominance of well-educated people with the self-confidence to accept the high levels of responsibility demanded by the new model.

Whatever the answer, we are sure it is not some peculiar cultural phenomenon. Much the same questions were asked about Japanese quality in the early 1980s and Scandinavian knowledge management in the early 1990s. Besides, we have seen evidence in many other countries of the new model working effectively.

Besides producing case reports and a guide to beyond budgeting, we have also prepared a diagnostic that will soon be used as the basis of a global benchmarking survey that we believe will provide a rich source of knowledge about how firms are moving away from the budgeting model, and whether or not those that *have* moved have experienced better financial results. The early indications from over 200 companies show that there is a statistically significant correlation between the beyond budgeting model and competitive success. Perhaps more surprisingly, the strongest correlation is with the people management factors rather than performance management. This only serves to reinforce our view that beyond budgeting has to be a twin-track programme progressing simultaneously along both the human relations and mechanistic pathways. Only then can we build a coherent management model to match our strategies.

Robin Fraser and Jeremy Hope are programme directors of the CAM-I Beyond Budgeting Round Table. If you wish to take part in the CAM-I survey (and see how the beyond budgeting principles apply in your organisation) visit www.beyondbudgeting.org.

There will be a half-day conference on Beyond Budgeting on 25 May 2001 organised by the Faculty *(See page 11 for details).*

TAX **UPDATE**

The Chancellor leaves us still in the dark

Francesca Lagerberg of the ICAEW's Tax Faculty suggests that the March 2001 Budget sprang few surprises and that the hoped-for clarity on certain issues remains some way off.

Francesca Lagerberg is the senior technical manager to the Tax Faculty of the ICAEW (www.taxfac.co.uk).

Full Budget Day press releases can be viewed on the Inland Revenue's web site at www.inlandrevenue.gov.uk.

From the perspective of business, the March 2001 Budget carried few shocks and little clarification. These are some of the key announcements.

Intellectual property relief, goodwill and intangibles

Despite three consultations in two years on this issue, the Budget announced yet another technical note on the issue – albeit with some draft legislation. The note runs to a massive 46 pages, which includes 10 pages of draft legislation.

The thrust of the proposals is that the tax treatment of intellectual property will follow the accounts treatment. This is what the Tax Faculty of the ICAEW has been asking for in its representations on the various prior consultations. Any profits on the disposal of intellectual property will be taxed as income not capital – this will produce winners and losers. Comments are being requested on the new proposals by 31 May.

The government has confirmed that deduction of tax from interest and royalty payments between UK companies will be abolished with effect from 1 April 2001. It is a shame to see this restricted to the UK only and not covering international transactions, bearing in mind that most intellectual property transactions are not confined to the UK. However, it was always unlikely that the Inland Revenue would agree to such an extension.

Relief for company gains on substantial shareholdings

The government plans to consult further on the proposed deferral relief for substantial shareholdings in companies. This is a proposal allowing a company to roll-over gains made on a disposal of shares in a company in which it owns more than 20% of the shares. A new consultation document will be issued in June with a view to legislation in the Finance Bill 2002.

It appears that the government may now wish to extend the proposed deferral relief into an outright exemption from capital gains tax on a disposal of shares by a company. If this is correct, then this development is welcome. If, however, the government intends to merely tinker with the existing proposed deferral relief, then this further delay is unfortunate.

Foreign exchange gains and losses etc

Another consultation is on its way in the summer to look at foreign exchange gains and losses, financial instruments and corporate debt. The intention is to open up discussion on how these rules can be reformed and integrated in a sensible way.

Double tax relief

The big 'story' of the last Budget was the rule changes to double taxation relief (DTR). This year's additions will be more welcome as they relax the on-shore pooling regime although some practical difficulties remain – not least the fact that the changes are due to take effect from 31 March 2001 and the draft legislation is not yet available.

Research and development (R&D)

A consultation paper entitled 'Increasing Innovation' sets out further thoughts on the proposed revised R&D tax incentive for large firms. This builds on the earlier enhanced R&D tax credit for small and medium sized enterprises.

R&D is very important to the UK and there are very good reasons to expand any tax credit to all businesses of whatever size. Comments are requested on this paper by 8 June 2001.

Enterprise Management Incentives (EMI)

We already knew that the original proposal to limit this incentive to just 15 key people was going to be removed. The Budget also announced that the amount of share options that small, growing companies will be able to grant under Enterprise Management Incentives will be doubled from shares worth £1.5 million to £3 million.

The following changes are also being made to the scheme:

- the time limit for notification of the grant of EMI options will be increased from 30 days to 92 days;
- the requirement to obtain prior approval for an alteration to share capital will be abolished; and
- the Revenue will provide advance 'clearance' as to whether or not a company qualifies for EMI.

These look like welcome extensions and should make EMI a more attractive option.

TREASURY **UPDATE**

Regulations, IT offerings and convertibles

In the first of his new Update columns, regular contributor **Chris Mansell** reports on some of the principal concerns facing those involved with treasury management.

New regulations

A draft of the Regulated Activities Order which will determine the scope of the Financial Services and Markets Act was published at the end of last year. It appears that the dealing activities of most corporate treasuries will remain unaffected.

The current rule is that principal transactions in securities will be excluded from regulation, unless there is 'holding out' of one party as a market participant. The definition of holding out is elusive, but is used to describe someone who stands ready to deal as a market participant as opposed to acting as a customer of that market.

Derivative transactions with or through authorised persons will remain exempt, as will all principal-to-principal intra-group transactions.

The main problem at the moment appears to be that a dedicated treasury company within a group would not be exempt. The hedging company has to be a normal commercial company.

Recent IT offerings for treasurers

IT solutions for treasury management continue to pour in from every quarter. Typical of the offerings are:

- EuroCash Ltd – this is described as a fully featured treasury accounting function, starting from the journal entries triggered by a financial deal, through accrual, revaluation, trial balance into the income statement and balance sheet. The user can define the desired accounting treatment – IASS 39, FASB 133 or the new fair value accounting standard proposed by the Accounting Standards Board. The software, just released, is sold either as a module of EuroCount treasury software, or as a component for other developers to incorporate; and
- TreasuryPortal – an on-line multi-currency and multi-entity treasury system providing a wide range of functionality. Accessed via a secure connection over the internet (ASP), the system enables companies to benefit from the latest technology without the investment required to install and then maintain the software in-house. The system covers deal administration, cash management, mark-to-market and accounting, with the flexibility to add further functions as needed.

Also, Atriax, the recently launched electronic, internet based foreign exchange marketplace which is scheduled to start trading in the middle of 2001, goes from strength to strength. Some 58 banks are now involved, apparently representing 62% of the market. The organisation is authorised to co-operate in 42 countries world-wide, the latest additions including Honduras and Romania.

There are many players in this internet market but Atriax could become the biggest, given the breadth of its participation. The expectation is that dealing costs will be cut and of course for the larger corporates there will no longer be the requirement to trade through a bank. The playing field has been really levelled out this time. (Contact: www.atriax.com).

Hybrids and convertibles

The time-honoured attraction of hybrids and convertibles has been their ranking as equity for accounting purposes and debt under the tax rules. There are several basic principles to be observed in assessing which side of the accounting fence an instrument falls, quite apart from the principle that all fund-raising instruments are either debt or equity:

- all types of share must be classified under UK company law within shareholders' funds;
- any obligation to make cash payments or transfer assets results in classification as debt;
- if the holder of the instrument has an option to receive settlement in cash or shares, the instrument is classified as debt;
- an instrument without obligations to transfer value must be shown in shareholders' funds;
- ultimate conversion of debt to equity may never be presumed in an accounting statement; and
- a share carrying a preference over basic equity or some restriction over dividends or capital on wind-ing-up is classified as non-equity capital.

Chris Mansell is a former treasurer and is now a director of several companies.

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.

24 April HALF DAY CONFERENCE (Manchester Business School, Manchester)	*THE 'ACCOUNTANTS AND CHANGE' CONFERENCE – PROFESSOR TONY HOPE, VISITING PROFESSOR OF ACCOUNTING AT INSEAD, MANCHESTER BUSINESS SCHOOL AND BRADFORD UNIVERSITY MANAGEMENT CENTRE AND PROFESSOR RICHARD THORPE OF MANCHESTER METROPOLITAN UNIVERSITY. CHAIRMAN, PROFESSOR JOHN ARNOLD, DIRECTOR, MANCHESTER BUSINESS SCHOOL.* The conference will examine how organisations are becoming more adaptable to the fast moving business world and the impact on traditional budgeting procedures. Topics include: 'Budgets – Boon or Bane?' and 'Making Sense of Change'. Registration and coffee 9.30am; chairman's introduction 9.55am; lecture - Tony Hope 10.00am; coffee 11.00 am; lecture - Richard Thorpe 11.30am, buffet lunch 12.30pm.
9 May FULL DAY CONFERENCE (Cranfield School of Management, Bedfordshire)	*THE CRANFIELD 'CHALLENGES OF MANAGEMENT'* CONFERENCE – *DR VERONICA HOPE HAILEY, PROFESSOR RICHARD TAFFLER, PROFESSOR CHRIS EDWARDS AND BILL HENNESSEY (all speakers are from Cranfield School of Management).* The content of the conference will be stimulating and will challenge your established ways of thinking within HR, management and e-business and finance. Topics include 'From education to learning, developing managers for an ever changing world', 'Behavioural finance', 'Managing a portfolio of "e" intiatives', 'Key issues in management development' and 'What really matters in linking HR and business performance'. Registration 9.00am; lectures 9.30am-3.30pm with breaks for refeshments and lunch.
25 May HALF DAY CONFERENCE (Chartered Accountants' Hall, London)	*'BEYOND BUDGETING – MATCHING MANAGEMENT TO STRATEGY'* CONFERENCE – *ROBIN FRASER OF CAM-I INC, BRUNO THALMANN OF ARTHUR ANDERSEN, AND DAVID BERKELEY OF BULMERS.* Robin Fraser, programme director of the BBRT, will explain alternatives to budgeting. Bruno Thalmann, a senior manager in Arthur Andersen, Switzerland will outline the Beyond Budgeting survey findings. David Berkeley, finance manager at Bulmers, will describe how his company abandoned budgeting for strategy. Registration 9.00am; lectures 9.30am-1.00pm followed by buffet lunch until 2.00pm.
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 by Booz, Allen and Hamilton found that, although both European and Asian managers scored highly on pre-bid skills, they scored worst in the planning and execution of the integration. Failure to plan early is a major problem and many businesses do not start this process until the deal is done. This programme will answer these questions, in a practical manner, by looking 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 you must 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 to 8.30pm.
12 September CONFERENCE (Leeds Business	*'E-COMMERCE' – PROFESSOR KEVIN KEASEY, HOLDER OF THE LEEDS PERMANENT BUILDING SOCIETY CHAIR IN FINANCIAL SERVICES, DIRECTOR OF THE INTERNATIONAL INSTITUTE OF BANKING & FINANCIAL SERVICES; AND PROFESSOR NICK WILSON OF LEEDS UNIVERSITY BUSINESS SCHOOL AND DIRECTOR OF THE CREDIT MANAGEMENT RESEARCH CENTRE.* Full details will be published in the May issue of F&M – or call Jacquie Lee on 020 8953 0758.

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 <u>the tear-off response form opposite</u>.
There is a charge of £5.00 for audio recordings and £10.00 for video.

THIS MONTH

COMPETING IN THE NEW ECONOMY
Professor David Asch of the Open University Business School considers some fundamental aspects of customer choice and the nature of buying decisions in the new IT environment.

The renaissance of private companies

While many public companies are suffering burnout in the effort to boost their profile and deliver value to shareholders, private companies – unhampered by such concerns – are undergoing a revival, as **Robert Bruce** explains

Robert Bruce is accountancy editor of The Times.

'Growing a private company – Commercial strategies for building a business worth millions' by Ian Smith is published by Kogan Page at £16.99.

Burnout continues to be the biggest problem with public companies. CEOs on average last an ever-decreasing number of years in the job. Companies which have tried every strategy known to them find their share price still on the slide. It is not just the Marks & Spencers of this world. Companies with good growth, excellent strategies but the misfortune to be in an unfashionable sector are baffled at what they should do to kick-start a slumbering or sliding share price.

Small wonder that business can seem a wearying treadmill. Unless, of course, you are talking of private companies.

Private companies are undergoing a renaissance. Partly it is to do with technology now allowing a small company to compete more easily across borders and against companies which are many times its size. Partly it is to do with bright entrepreneurs wanting to build a company without the pressures of analysts, share prices, quarterly results and short-term expectations.

Victorian model

We are, in some ways, seeing a return to the Victorian model of capitalism. David Allen – a past-president of CIMA, the management accounting body, and these days a non-executive director for a number of private companies – points out that the earlier model tended to be a small number of shareholders, all committed to the business. He contrasts this with today's institutional investors' tendency to desert what they see as a problem company as soon as possible.

As a result, large and supposedly sensible companies lurch from strategy to strategy and pour their funds into the pockets of consultants, and have long since given up thinking how the company could build a long-term future.

Hence private companies. For Allen the problem is a simple one. There are too many pressures on public companies to do things other than what is right for the company, he says. There has to be, for example, a point where short term profits to please the critics hold sway over a possible decision to spend on research and development – times when decisions are aimed at ramping the share price to ensure that the directors' share options are fulfilled rather than targeted on longer term growth. At a private company, you are able to think long-term, he says.

E-business

Ian Smith of Aximus has been involved in private companies all his working life and has just published a book on the lessons learned. He is enthusiastic about business environment changes which tilt the balance towards private companies. Part of this is the e-business revolution, making the size of a company no longer crucial to its potential business reach, for example. Businesses can operate across borders regardless of their size.

"I like the idea of a sliver company", he says. "It means that a private company can be global. It can slice the idea of its niche even finer. Just a sliver of a global market, enabled by e-business, can be hugely profitable."

Smith's book provides a strategy for growth. And as he points out it only takes a few deals before the small private company is up there competing with the best.

After all, the niche player is not taking on the multi-national across the board. You are only competing against a division of a multi-national at that point, says Smith. It can be done.

The Faculty of Finance and Management,
The Institute of Chartered Accountants
in England and Wales,
Chartered Accountants' Hall,
PO Box 433, Moorgate Place, London EC2P 2BJ
Telephone: 020 7920 8486
Fax: 020 7920 8784

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND & WALES

The Faculty's web site address is – **www.icaew.co.uk/members**