

# Agenda

Insights into growth, performance and governance

## Secret wealth

How to unlock millions with smart cash management

## Gangster business

Can a godfather help you become a better manager?

## Outsource your CEO

The revolution that could transform your business

**“We can now distinguish between a rising market and a genius”**

Smith & Nephew's **John Buchanan** on prospering in a downturn

# “Your opening question may be: why does this magazine exist?”

**BERND SCHMID**  
Global Head of  
Advisory



Its role is simple: it offers insight into issues on every CFO's agenda. The name *Agenda: insights into growth, performance and governance* highlights three of the concerns that are at the heart of KPMG's advisory services.

Globalization has made business more complex. It's a cliché but it happens to be true. This magazine reflects that complexity with a broad, yet detailed, remit that demonstrates the breadth and specialist depth of the advisory services KPMG firms deliver. So whether you're considering knowledge process outsourcing (p16), cash management (p30), or focusing on the basics (p12), you should find this of interest. It will even tell you how the Watergate scandal can enhance your decision making (p35).

In such volatile times, the prediction business is best left to dealers and visionaries. This magazine doesn't gaze into the future but, by offering a variety of informed, independent opinions on the issues that matter, it will help you prepare for it. ”

Simon Puschmann/Schierke  
Photographers

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# strategic intelligence

## The shocking truth about China It may hit ambitious renewable energy targets

While the world has been scrutinizing Beijing's air quality in the run up to the Olympic Games, China has invested US\$10.22bn (€6.48bn) in renewable energy sources and set aggressive, legally binding renewable energy targets.

Even Lo Sze Ping, campaign director for Greenpeace China, says: "China can do more but it is acting. Its binding renewable energy and efficiency targets are stronger and more ambitious than in certain industrialized nations."

The investment reflects a nation desperate to shake-off a reliance on fossil fuels (coal accounts for 70 percent of its energy, compared to a global average of 42 percent) that has left it vulnerable to increased environmental, economic, social

and security risks. Oil is now too expensive for China's needs, smog delays flights, while pollution damages crops. The financial benefit could be huge: pollution accounts for 10 percent of China's GDP.

China can change quickly

# 60

*percent of global solar energy powers Chinese households*

when it wants to. Last year, 60,000 taxis and buses were removed from Beijing's roads and thin plastic bags were

banned this June. Hundreds of small coal-fired power plants have been shut, with many more set to close.

By 2020, China aims to get 15 percent of all its energy – double its current usage – from wind, biomass and hydropower. The country is a global manufacturing powerhouse for solar technology – third only to Japan and Germany – and one in 10 Chinese households use the sun to heat their water.

Ping says: "Wind installed capacity grew by more than 100 percent in 2005 and 2006. But China should have much bigger ambitions for wind and solar energies."

Droughts, floods, typhoons,

and shrinking glaciers have convinced Chinese leaders that environmental change is the key to national prosperity. If the energy plans are implemented, China will cut CO<sub>2</sub> emissions by more than 1.5 billion tonnes over the next five years. But how will this balance against the nation's growing thirst for consumerism?



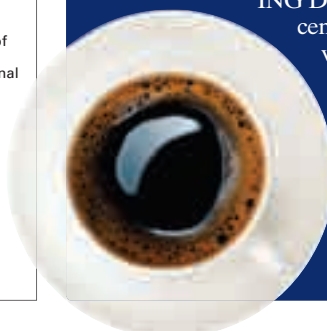
Samantha Sin/Getty Images

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## microtrend Mochas and mortgages

How do you lure people into your bank when research proves we speed up as we walk past? Offering coffee and reading areas in branches styled like plush hotel lobbies helped Umpqua in Oregon. At ING Direct customers can sip and surf the net as they save. New Barclays Premier centres in Porto, Madrid, and Delhi feature concierges, private meeting and videoconferencing suites, and are stylishly furnished by leading designers. In Zurich, Credit Suisse is enhancing the customer experience with special scents (sandalwood for the lobby, grapefruit for meeting rooms).

Mixing hot drinks and finance isn't new. Lloyd's of London started in a coffeehouse in 1688. With chip-embedded ATM cards that alert staff when you enter a branch, your manager may soon greet you, latte in hand. Banking can think outside the box. But Lani Hayward, Umpqua vice-president of creative strategy, says: "You have to have an innovation culture. Lone innovators will die quickly, especially in banking."



Shutterstock

# Are trains the new planes?

As airlines come under scrutiny over cost, safety and environmental concerns, rail transport is booming. Europe is connecting its cross-border networks with one schedule and pricing system, but what's next for rail in the rest of the world?

## 1. U.S.

The California High Speed Rail could link LA and San Francisco in 2.5 hours.

## 2. ARGENTINA

Work on South America's first high-speed line is due to start.

## 3. SPAIN

A tunnel through the Pyrenees will take the French high-speed network into Spain by 2009.

## 4. IRELAND

A Dublin metro system, fully open by 2014, will transform the gridlocked Irish capital.

## 5. SWITZERLAND

A 34km land tunnel under the Alps will be the world's longest.

## 6. TURKEY

The Marmaray rail tunnel linking the European and Asian halves of Istanbul will be the world's deepest undersea tube.

## 7. AFGHANISTAN

The only line out of Afghanistan to Turkmenistan will give it access to Asia, Russia and Iran.

## 8. MALAYSIA

Malaysia to Singapore could take 90 minutes if this first trans-border high-speed line outside Europe goes ahead.

## 9. KOREA

The freight service between North and South Korea is the first for over half a century to cross the border.



## Mind games

### Denmark's bid to reinvent public services

MindLab may sound like a fictional creation by Mary Shelley, but it's actually the name of an organization which unites government, private enterprises and the research community in Denmark's drive to improve public sector innovation.

The ministries of Economic and Business Affairs, Taxation and Employment are behind the internal consultancy, set up last year to promote innovation in public policy and service delivery and create value for the ministries by helping them rethink the way the public sector works. Taxation minister Kristian Jensen says: "We cannot solve our problems with more funding. We cannot solve it with more available hands – we do not have them. We need innovation."

Led by innovation manager Christian Bason, sociologists, IT managers, anthropologists, designers and students will work on various research projects run by cross-ministerial teams that will give end-users – the public – a say in policy development. Denmark's small and medium-sized enterprises will be first to benefit, after MindLab consulted civil servants to find ways to cut the time companies spent meeting rigid regulations.

# leading edge

## Speed up innovation during a slowdown



CEOs often make serious mistakes when the economy slows. Unless you really can compete on price, sustained innovation is the one competitive edge left, driving performance, growth and stock market valuation. Here's what not to do if you want to stay ahead...

### 1. Fire talent

Cutting back on people – particularly smart, high-priced people – cuts costs. But talent is the single most important variable in innovation.

### 2. Cut back on technology

The rise of social networking and consumer power means companies must be in a larger conversation with customers and spend big on IT.

### 3. Reduce risk

Innovation requires taking chances and dealing with failure. Recessions push managers to be more conservative. They must fight this.

### 4. Stop product development

When growth returns, companies who have cut back on new products and services have fewer offerings to attract customers.

### 5. Replace growth-oriented CEOs with cost-cutters

Most recessions last only two or three quarters and, these days, are relatively shallow. Penny-pinching CEOs don't have the skills to grow when growth returns.

### 6. Retreat from globalization

It's expensive to expand globally and managers often cut back on emerging markets. Big mistake. Emerging markets are sources of new revenue, business models and talent.

### 7. Retreat into walled castles

Cutting back on outside consultancies is an easy save. Yet outside innovation and design consultants know how a broad range of companies are promoting change. If you don't know this, it can hurt your global competitive position.

### 8. Downplay innovation

When turning defensive, top managers downplay innovation and prioritize systems management and squeezing costs. The entire organization follows. It is extremely hard to reverse this.

### 9. Change performance metrics

To cut costs, managers shift employee evaluations away from rewarding riskier new projects toward sustaining safer older goals. Risk-averse behavior ensues. Again, this is hard to change.

### 10. Replace collaboration with hierarchy

The need for fast decision-making when profit suddenly drops often signals a return to command-and-control management, which alienates creative employees and stops the evolution of corporate organization toward a flat, collaborative open-source model.

Winners emerge out of recessions with something new. Apple worked on iTunes, iPods and its retail stores during the last recession and came out swinging to destroy its competition. Apple didn't make any of the above mistakes. Your company shouldn't either.

Bruce Nussbaum is innovations editor of Business Week

# Make your strategy stick

The best ideas – ones that ‘stick’ – are simple. Bestselling business authors Chip and Dan Heath say good ideas are also unexpected, concrete, credible, emotional and tell stories. Chip Heath explains what this all means for your business...

## You talk about the curse of knowledge in your book. What is this and do CEOs suffer from it?

Definitely. The curse of knowledge happens because when we know something, it becomes hard for us to imagine not knowing it. And this makes us lousy communicators.

Think of the IT guy who can't give you a clear answer to an IT question. We're all like the IT guy in our own domain. The better we get at generating great ideas, the more unnatural it becomes for us to communicate those ideas clearly.

## Is 'stickiness' important in a business strategy?

People understand, remember and act on sticky ideas. Imagine if you had a strategy that wasn't just written in a binder but changed how employees made decisions every day.

## What do leaders struggle with most when promoting new ideas?

Concreteness. Take an abstract message like "Maximize

shareholder value." What should your staff do to maximize shareholder value tomorrow?

## Give us an example of a sticky strategy

FedEx tell stories any employee can understand. One is about a driver who realized he couldn't open one of the pickup boxes on his route – he'd left the key at his office. His deadline was tight and he knew that if he drove back and got the keys the package would miss the plane. So he got a wrench, unbolted the whole box and muscled it onto his truck knowing he could unlock it at its destination.

That's the kind of behavior you want when your competitive advantage is 'absolute positive reliability.' That story is better than the best PowerPoint presentation.

Trader Joe's describes its target customer as an unemployed college professor who drives a very used Volvo. That's funny and clever, but more importantly it's practical – Trader Joe's workers share a common mental image of who they're serving.

Use stories. People remember stories, not advice. Aesop's Fables have endured for centuries, but Aesop's Thesis Sentences wouldn't have lasted 10 minutes. Stories let us vicariously experience situations we haven't seen yet. Any manager will have lots of stories about hard-won insights.

## What else should leaders remember?

Surprise grabs our attention. Nordstrom is an upscale department store that justifies high prices by really outstanding customer service. They spend a lot of time telling unexpected stories, like that of the 'Nordie' who gift-wrapped a package a customer bought at Macys. These messages highlight the uncommon sense about Nordstrom's outstanding customer service. Firms like Wal-Mart talk about customer service, but don't tell the same kind of stories as Nordstrom.



AFP/Getty Images

# Redesign on the cards

RevolutionCard, from AOL co-founder Steve Case, is an appropriate name for a credit card with giant-slaying aspirations. Case's new card attracts merchants by charging just 0.5 percent of the purchase cost (against an average of 2.2 percent per transaction on credit cards, 1.75 percent on debit cards). If savings are passed on to consumers, it could shave hundreds off purchases. Consumers also get enhanced security: Case believes having a name on the front of the card is an open invitation to identity thieves. RevolutionCard has just a 16-digit account number on the front, protected by a PIN that can be changed as often as required.

These changes represent the biggest shake-up in the credit card market since the flexible plastic took off 60 years ago, but Case says its success relies on mass support: "This is the classic chicken-and-egg situation. It makes sense only if you get lots of merchants accepting it and lots of consumers using it – which is hard."



# Leipzig's boom time

The biggest financial centre in central Germany, with a new orbital motorway, expanded airport, a long tradition of hosting successful trade fairs and 6.8 million people within a 100km radius, Leipzig is attracting serious investment from such big corporate names as Porsche, BMW and DHL.

Porsche has spent €150m (US\$233m) on its new production and logistics plant while DHL, in a joint venture with Lufthansa Cargo, will make Leipzig airport its megahub for freight flights across the globe. A center of commerce for 800 years, home to one of Europe's most famous trade fairs, with a cheap, well educated workforce, and Germany's oldest business school, Leipzig is ready to fly.

## Leipzig data

- Population:** 508,605
- City GDP:** €11.7bn (US\$18.2bn)
- Largest employer:** BMW (5,400 staff)
- Visitors:** 991,420 (2007, 12.7 percent up on 2003)
- Investment capital attracted:** US\$2.51bn (2006)
- Airport air freight tonnage:** 101,283 (in 2007, 984 percent higher than in 2003)
- Number of firms:** 35,011 (in 2007, 30 percent higher than in 2003)
- Home to:** Bach festival, Games Convention, Leipzig book fair and 34 trade fairs

DPA/PA Photos



# what I'm reading



Jon Rigby

## Steve Ridgway, CEO, Virgin Atlantic

- **The World is Flat** Thomas Friedman (Farrar, Straus, Giroux). How the world is becoming a level playing field. Aviation, with its desire for deregulation, could learn a lot from this.
- **Zoom** Iain Carson, Vijay V. Vaitheeswaran (Twelve). Brilliant insight into how carmakers and oil firms tackle global warming.
- **Who Moved My Blackberry?** Lucy Kellaway (Viking). Captures the hilarity of our fast-moving world.
- "I also recommend [www.economist.com](http://www.economist.com) for sensible, reasoned discussion about the world around us."



Donna McWilliam/AP/PA Photos

## Renewable energy: too hot to handle?

Is the hunger for sources of renewable energy in danger of overheating the market? It's a question energy corporates might do well to consider, as government and public demand fuel an increasing number of significant acquisitions.

Recent deals – including Scottish and Southern Energy's €1.4bn (US\$2.2bn) swoop for Airtricity – have made the renewables market one of the fastest-growing emerging sectors. The rise in oil prices, coupled with an increase in worldwide government support and subsidies available to renewables producers, has created a climate of confidence in the future and an appetite for acquisitions.

KPMG International's Global Renewables Survey shows half of respondents believe there is a risk of a renewable energy bubble. Is there a risk of over-confidence here? Andrew Cox, KPMG's Global Head of Energy and Utilities for Transaction Services and partner in the UK firm, says: "Industry players need to carefully assess all the many risks involved in investing in renewables, such as the ability of national governments to change their green energy policies... investors are putting money into technology that could become obsolete very quickly."

And yet, says Cox, "early investment made now in renewables could prove an insightful move in years to come." For a full copy of the report, email [renewables@kpmg.co.uk](mailto:renewables@kpmg.co.uk).

# CEO blogs

## The edited highlights

### IT standards

"De facto standards are the only ones that matter. Well-intentioned standards bodies can do their best, but volume deployment is the only setter of standards. Ubiquity trumps policy, just about every time." *Jonathan Schwartz, Sun Microsystems CEO (blogs.sun.com/jonathan)*

### CEO pay

"Firms will always be a lot more stringent with their cash, whether it's paid to the CEO or anyone else, than stock. Forget stock and make CEOs live in the cash zone. Cash compensation will go up, but total compensation will come

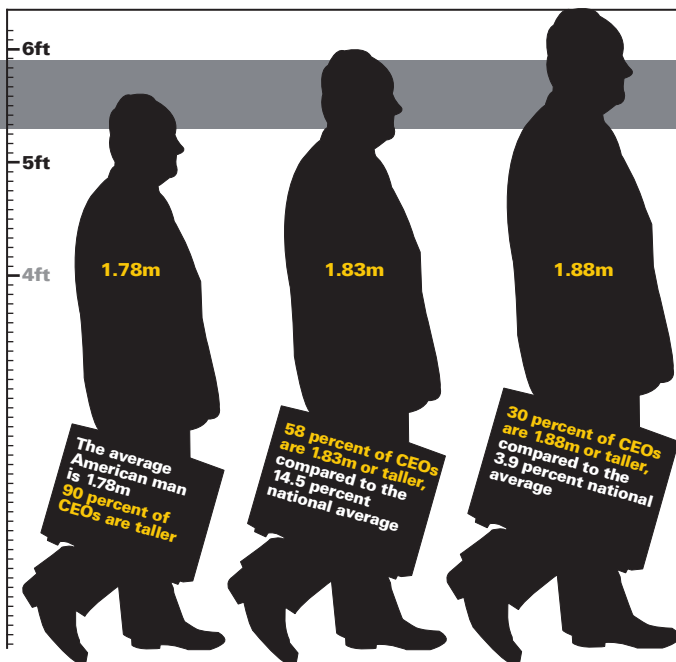


Sean Gardner/Reuters/Action Images

down. CEOs paid huge sums in cash will stand out like a sore thumb when things aren't going well. They'll be treated like everyone else and held far more accountable." *Mark Cuban, CEO of NBA side Dallas Mavericks (www.blogmaverick.com)*

### Innovation

"The sources of innovation are more diverse than we think. There is not always a clear line between success and failure: some successes are based on pieces of innovation that were deemed failures at the time. You must be open to what can work and what needs emerge over time, not stick to a rigid formula." *Mike Critelli, chairman Pitney Bowes (www.mikecritelli.com)*



## The height of success

It's easy to spot a CEO: they tower over everyone else in the boardroom. While researching his 2005 book *Blink: The Power of Thinking Without Thinking*, author Malcom Gladwell discovered that 30 percent of CEOs are over 6ft 2in/1.88m tall. Similar studies show that more than 90 percent of CEOs are of above-average height. Those extra inches add up to hard cash: a 6ft/1.83m person earns on average US\$5,525 more than their 5ft5in/1.65m neighbor. That's US\$789 an inch, or US\$306.94 a centimeter. Which only begs the question: should there be a tax on height?

# What's on their 'to do' list?

They span the globe from French nuclear power to Brazil's low-cost airline to China's answer to Google. They have an average age of 41, and they face serious career-defining challenges. Here are five business leaders with plenty on their agenda...

BY RHYMER RIGBY



# 01

## ANNE LAUVERGEON

*48, president of French energy group Areva*

Thanks to global warming and high oil prices, nuclear power has gone from has-been to contender. The French have long supported nuclear energy and, under Anne Lauvergeon's leadership, Areva boasts operations in 43 countries as far apart as Sudan, Argentina and Japan.

**The story so far** Lauvergeon is one of the world's most powerful women. After advising François Mitterrand and stints in banking and telecoms, she became CEO of French state-owned nuclear group Cogema in 1999. Two years later, she led its merger with other companies to create Areva. She is a superb networker, forging strong relationships with Alcatel-Lucent chairman Serge Tchuruk and ex-Renault CEO Raymond Lévy, and such a vocal, persuasive champion of nuclear power that the French press has dubbed her 'Atomic Anne'.

**What's next** With world electricity use set to double by 2030, Areva is perfectly poised to strengthen its global market presence. The group has submitted reactor designs to build the first new nuclear power stations in the U.S. for 30 years, is bidding to run the U.K.'s Sellafield site, and has won a US\$12.6bn (€8bn) contract to build two reactors in China.

Areva's future will be shaped by the fate of the new European Pressurized Reactor (EPR), which it won the license to build alongside Siemens. The first reactor – being built in Finland – is behind schedule and over budget but Areva expects its Flamanville plant to run an EPR by 2012.

The French government has been considering part-privatization or a merger. Lauvergeon has so far successfully opposed the second of these.

**She'll be successful if...** EPR succeeds and Areva wins the PR war by building cost-efficient and safe nuclear reactors – and avoids privatization.



02

**ROBIN LI**

39, co-founder of Baidu, the Chinese Google

Google may be the global internet giant, but in the fastest growing market it is a poor second. At the end of 2007, Baidu (the name means ‘hundreds of times’) held 60 percent of the Chinese search market, compared to Google’s 26 percent. Globally, Baidu is third in search, behind Google and Yahoo!. In February, founder Robin Li moved Baidu into Japan where it is already fourth in search.

**The story so far** Born in the impoverished province of Shanxi, Li founded Baidu with Eric Xu in 2000. It now indexes over a billion web pages and is used by 90 million people a day (around 100 million Chinese use the Internet). When Baidu floated on NASDAQ in 2005 the stock price quadrupled in 24 hours.

**What’s next** Baidu’s revenues more than doubled to US\$237m (€150m) in 2007 but Li knows Google won’t relinquish the world’s biggest online market without a fight. Yahoo! has bought 40 percent of the Chinese online retailer Alibaba for US\$1bn (€634m) and Microsoft now has a Chinese portal.

Li faces a hostile entertainment industry, which says Baidu isn’t cracking down on online piracy. EMI won a suit over Baidu’s MP3 service in 2005. The Chinese copyright agency is now suing, though Baidu’s search engine links to pirated music have been ruled legal for the time being. As Google offers free, legal music downloads in China, Baidu will stake its future growth on new products – voice-activated search, an instant messaging program and an online marketplace to rival Alibaba – expansion into Korea and Japan and delivering more lucrative services to advertisers.

**He’ll be successful if...** Baidu can avoid cross-cultural conflict as it enters new territories, while maintaining its market share against the challenge of Microsoft and Google in China.

01 Eric Piermont/AFP/Getty Images 02 The New York Times/Eyevine 03 Ferrexpo



03

**KOSTYANTYN ZHEVAGO**

33, Ukrainian politician and billionaire

Kostyantyn Zhevago, head of business empire Ferrexpo, is the world’s youngest self-made billionaire and the 891st richest person in the world. But in Ukraine’s fast-changing business environment – and with a parallel career as a member of parliament to think of – does he have what it takes to deliver on his early promise?

**The story so far** Zhevago started in business as a student, made a fortune selling shares in Ukraine’s newly privatized companies and, in 1992, became finance director of Finance and Credit, which he runs alongside Ferrexpo, a diversified group with interests in banking, hydrocarbons, manufacturing and iron ore. He restructured the iron ore business, floating it in London in 2007, and looks set to buy Mittal’s Bulgarian steel interests.

**What’s next** With Ukraine stabilizing, the big challenge is to modernize the antiquated technology and infrastructure inherited from the Soviet Union to attract foreign capital.

Ferrexpo already has the fourth largest iron ore reserves in the world but wants a foreign partner to help it quadruple its output to 100 million tonnes by 2018. China needs to find alternative suppliers to CVRD, BHP Billiton and Rio Tinto-Zinc – which control 70 percent of the market – and Chinese firms are frontrunners to help Zhevago. He can afford to be choosy: Ferrexpo’s capital spend in 2008 may reach US\$394.3m (€250m). Some of this may be spent buying iron ore interests in Ukraine and other former Soviet republics – if he can find books that stand inspection – or snapping up any units divested if BHP’s bid for Rio Tinto succeeds.

**He’ll be successful if...** Ferrexpo can find the right foreign partner and invest the extra cash generated by higher iron ore prices in shrewd acquisitions.

*Lauvergeon is such a vocal, persuasive champion of nuclear power the French press has dubbed her ‘Atomic Anne’*



04

HARTMUT OSTROWSKI

50, CEO of German media giant Bertelsmann

A real entrepreneur, Hartmut Ostrowski vowed to raise turnover by 50 percent and operating profit by US\$4.7bn (€3bn) in eight years when he took charge at Bertelsmann this year. And he will take the media empire out of its comfort zone to do so.

**The story so far** Ostrowski was asked to run Bertelsmann, a foundation-owned global media group, after generating huge amounts of cash from Arvato, its communication and media services operation, by focusing on new customers, services and countries. He lives in Bielefeld where he's known as a football fan who walks his dog in his track suit – all substance and no style, say pundits.

**What's next** Running a modern media company has been likened to map-making in an earthquake zone, and Ostrowski wants to grow Bertelsmann's business. He is ready to be radical – he may offload the group's struggling book clubs, once the soul of the business, and its half-share in SonyBMG, hit by a 20 percent slump in U.S. CD sales.

But he could spend US\$7.8-10.9bn (€5-7bn) buying smaller companies with strong cash flows over the next five years. He has urged managers: "Take the lead. Go for growth. Create value." He is aiming for an organic growth rate of four percent and has ideas to bolster TV arm RTL, diversify into China, India and Russia and make Bertelsmann more Internet savvy. His old firm, Arvato, is making a strategic pitch to supply public sector services in the U.K. and Germany. His big challenge may be stamping his authority on a group famed for boardroom spats.

**He'll be successful if...** the rhetoric that Bertelsmann is a 'content provider and producer' becomes reality online, managers think like entrepreneurs and diversification into the public sector pays off.

05

CONSTANTINO DE OLIVEIRA Jr

38, boss of Brazilian airlines GOL and VRG

Rather than fritter away the family fortune, Constantino de Oliveira Junior launched Brazil's first low-cost airline. Comparisons with Easyjet's Stelios Haji-Iannou are inevitable, but de Oliveira Junior has so far shown no desire to build a GOL-themed empire.

**The story so far** A licensed pilot, the entrepreneurial son of a bus transport tycoon has worked in transport since he was 16. After studying business he joined the family firm (Aurea) in 1994, leaving six years later to set up GOL, which went public in 2004. After buying national carrier Varig, GOL is now Brazil's second biggest airline and made a US\$65.9m (€41.8m) profit in 2007.

**What's next** Many see the Brazilian aviation sector – particularly its air traffic control systems – as chaotic, an impression underscored in 2006 when 154 people died after a GOL flight was clipped by a private jet and crashed in the Amazon rainforest. Infrastructure is slowly improving, but public confidence and passenger numbers have dipped.

As GOL's stock has fallen, de Oliveira Junior has faced some tough decisions over whether to take GOL private: he has resisted the idea so far, but rising oil prices and fiercer competition – David Neeleman, former CEO of JetBlue, is contemplating a move into Brazil – could make this a tough year.

But GOL has 10 daily international routes and expects traffic to grow by 37 percent in 2008 with new routes and new planes. It also has a code-sharing agreement in place with numerous other airlines through its VARIG brand, giving it access to a wider global network.

**He'll be successful if...** he can stand firm in family rows, persuade the government to boost confidence in Brazilian air travel and maintain growth. ●

*"Take the lead. Go for growth. Create value." Bertelsmann's Hartmut Ostrowski ensures his managers are on-message*

GO FURTHER

Find more about these businesses at: [www.aveva.com](http://www.aveva.com); [ir.baidu.com](http://ir.baidu.com); [www.ferrexpo.com](http://www.ferrexpo.com); [www.bertelsmann.com](http://www.bertelsmann.com); and [www.voegol.com.br/INT/](http://www.voegol.com.br/INT/)

# 1 left field

## The **management don**

He may be a paranoid, homicidal gangster but Michael Corleone can teach today's CEOs a thing or two

BY PAUL SIMPSON

**M**ichael Corleone is one of modern management's great tragic heroes. At the end of *The Godfather II* he is a shell of a man, gazing blankly over Lake Tahoe. His strategy – diversify to reduce his business's dependence on a fiercely competitive market (crime) – was spot on. His tactics weren't. He was, James Surowiecki notes in *The Wisdom Of Crowds*, compromised by the way his empire was organized. Much like many CEOs.

Corleone's mafia had a similar structure and organizational flaws to the traditional vertically integrated, top-down corporation that became prevalent in Western business from the 1900s. After becoming more bureaucratic and complex in the 1950s, many firms were re-engineered and decentralized in the 1980s, but not reinvented. Many aspects of the old corporate model – especially hierarchies, the concentration of power and vertical integration – still live on.

As the boss of a global business, Corleone had the edge on many CEOs. The structure of the business – and the force of his leadership – meant he avoided the bureaucratic excesses highlighted by Tom Peters and Robert Waterman, who, in their bestseller *In Search Of Excellence*, printed a chart from an unnamed U.S. firm showing that a new idea had to traverse 223 different paths to be accepted. Corleone could make decisions fast and be confident they'd be executed because subordinates knew he was willing to execute them instead if not.

Like any new CEO, Corleone was keen to establish his authority and use his mandate for change. Announcing “today I settle my family business” and having rivals killed was his gory corporate purge. Such ruthlessness might work for gangsters. But other businesses must consider morale and cost. HR experts say it can cost from 31-100 percent of an employee's salary to replace them. Corleone has two advantages: killing people avoids expensive redundancy payments and his recruitment methods are brutally effective. Businesses without these advantages shouldn't emulate him.

Michael's father Vito practiced what U.S. business

coach Erik Mazzone calls “command and connect” management. He is “constantly meeting people, listening to them, connecting with them.” He gives tough orders but “never tells people how to get something done: that is left to their discretion.” His son is a classic “command and control” manager, like those who led General Electric before Jack Welch became CEO in 1981 and reinvented the company. At least Corleone's minions, unlike GE's old-school execs, didn't have to do much form-filling.

Corleone's isolation was compounded by what *Business Week* calls “CEO disease”, a process in which a chief executive's worldview is distorted because they only glean information from top management. Corleone blundered in firing his consigliere, lawyer Tom Hagen, who gave him the disinterested counsel and unpalatable truths that had informed his decision-making. Vito, in contrast, always insisted on hearing bad news immediately.

Many management thinkers believe there is a deep-seated hostility among leaders to opposition from subordinates. So information that may help CEOs make smarter decisions is buried if it seems ‘off-message’ and the company doesn't learn. In the 1980s, General Motors' executive committee simply refused to believe a fact-finding study from a senior executive showing that Toyota was making as many cars as GM with half as many staff. Only when that executive, Jack Smith, became CEO in 1992 did GM shed the layers of bureaucracy that nearly destroyed it. Smith then emulated Vito Corleone: meeting to discuss strategy and performance with top managers for a day-and-a-half every month. Command and connect didn't cure all GM's ills but it is still the world's largest carmaker.

Michael Corleone led with a loaded machine gun but his troubles were far from unique. His credo – “trust no one” – left him as isolated as Josef Stalin. After suffering a stroke in March 1953, the Soviet dictator was effectively left to perish by subordinates who feared they would die in his next purge. There's a lesson there for CEOs everywhere. ●



Everett Collection/Rex Features

### HOW TO CURE ‘CEO DISEASE’

#### 1 BLOGS

Bosses who blog include Bob Lutz (General Motors), Jonathan Schwartz (Sun Microsystems) and John Mackey (Whole Foods). Lutz's blog (at <http://fastlane.gmblogs.com>) gets many hits within GM, making him more accessible to staff.

#### 2 REALITY CHECKS

Research shows leaders' moods can massively affect employees' behavior. One U.S. CEO believed managers found him upbeat and reliable. In fact, those reporting to him regarded his cheerfulness as fake and his decision making as erratic.

#### 3 PEER NETWORKS

CEOs open up with members of the same corporate species. Vistage, founded in Milwaukee in 1957, links up 14,000 CEOs in 16 countries.



# “We need humility and not hubris, a clear, robust strategy and to rediscover the art of saying no”

Smith & Nephew chairman John Buchanan says the slowdown is a chance for bosses to drop bad habits and focus on the basics

WORDS BY PAUL SIMPSON PHOTOGRAPHY BY JASON JOYCE

**E**conomic downturns, like hostile takeover bids and tax demands, tend to focus the mind. To John Buchanan, the former BP chief financial officer who is now chairman of healthcare giant Smith & Nephew – and a non-executive director of BHP Billiton, AstraZeneca and Vodafone – the slowdown is a chance for business to get back to basics. For some, it's an opportunity to put the house in order and discard some of the practices adopted in the boom years that now seem ludicrous, obsolete or just plain wrong.

In a meeting room at Smith & Nephew's minimalist head office in London's West End, Buchanan mulls over the state of business. Dapper and soft-spoken, he signals a change of emphasis more often with his hands than with his voice. And, notified of the general subject of the interview, he has taken time to scribble some notes on a sheet of paper just to make sure he ticks off all the points.

He doesn't normally do interviews. The cult of personality such activity implies doesn't quite square with his fervent, though quietly expressed, belief that management is always a team effort. He is talking this morning, not in his capacity as chairman or a non-executive director, but rather as someone who, since he joined BP in 1970, has

experienced two serious recessions and a few economic blips, and believes that smart management can soften the effects of a downturn.

“In good companies, people never tend to lose sight of the basics,” he says. For him, these basics are: “A clear, robust strategy – not one that is agreed upon and then stuck in a drawer but one that is live and constantly being updated. Clarity of purpose. Making sure you understand the risk issues. Focusing on the key value drivers in your business. Testing performance all the time. It's important not just to test the strategy against the current price environment. Business is cyclical so you need to imagine other scenarios. Try asking yourself, ‘How would this strategy look if prices were at the 10-year low?’”

“When business is on the up, it's easy to lose sight of all this. We've seen it happen in dot-coms and banking. People get into a race for top-line growth and market share, forgetting the qualifier – that growth must be profitable.”

Buchanan takes care to ensure this doesn't sound like a lecture, sympathizing with managers who feel the need to deliver growth. “There are markets or opportunities – the dot-com boom was one – which are literally too good to be true. And it can be very hard to stand back from the herd. You

## Smith & Nephew at a glance

**The UK's largest medtech company, with more than 1,000 product lines**

Areas of specialization include: orthopaedic reconstruction, orthopaedic trauma, endoscopy and advanced wound management

**Total group turnover (2007):** US\$3.4bn (€2.5bn)

**Markets (2007):** U.S. 46 percent, Europe 26 percent, U.K. 9 percent, rest of world 19 percent

**Employees:** 9,200 in 32 countries

**R&D spend (2007):** US\$142m (€103.8m)

## The keys to success



risk looking very foolish. Sometimes, the art is in the timing, when you get in and get out.”

Though he emphasizes that he has no special insight into the economic situation, he gently suggests that the pain is far from universal (“In resources, for example, we’re still being driven by the remarkable compound growth in the Chinese and Indian economies”). He wonders if suffering stock market traders are extrapolating their misery when considering the economic outlook. The people he talks to in industry are not as bearish as in the financial community. But the stock market is skittish, inclined to overreact to a hint of bad news.

Buchanan has one surprising reason for optimism. “America is hurting, which means it is in America’s interests to solve this. America is a tremendously flexible and innovative society. In the 1950s, they got a shock when the Soviets sent the Sputnik into space, but in little more than a decade the Americans had put a man on the moon.

And look at the Bear Stearns episode, how cleverly, quickly and flexibly that was handled, how the most disastrous consequences were averted. So, in the medium term, I expect them to solve this.”

After such a long boom, any correction was going to be a shock, but Buchanan feels the effect has been exacerbated because: “You now have a lot of people in business who’ve never experienced a downturn. You need a balance of experience, youth and new ideas in your management, and,” he says with a smile, “you need the ability to tell the difference between a genius and a rising market.”

If recessions have a purpose, it may be to instill a necessary sense of humility in managers who have come to believe their own hype in the good years.

He has one small last thought on how businesses can help themselves: “Too many companies focus on the what, and too rarely ask how. Pay attention to these kinds of things and you will lessen the chances of your company getting into difficulties.”

### SOUND ADVICE

- 1 Develop a clearly defined strategy. Update it constantly.
- 2 Be sure to understand the risk issues.
- 3 Focus on your key value drivers.
- 4 Continually test performance – and your strategy – against falling prices.
- 5 Manage your cash. Remember, growth has to be profitable.
- 6 Focus on what must be done but never forget the “how” bit.
- 7 Recruit wisely. Ensure some senior staff have survived a downturn.

This does imply, I suggest, that some businesses have contributed to their own downfall. Does he believe that? His voice acquires a more urgent and impassioned timbre as he answers: "I have always thought that you get what you incent. Think of Enron. If you're incentivizing the wrong things, don't be surprised when you get them." Rewarding staff to deliver growth or sales at any cost – without considering profit – is strategic folly.

Incentivizing the wrong things is one aspect of what Buchanan sees as a bigger problem: an unrealistic approach to remuneration. "We seem to have lost the art of saying no. If you have a genius who thinks he's worth three times as much to the business as you do, maybe you should take the risk that he might go elsewhere. It comes down to a game of poker but, as a manager, it's a game you have to play."

The compensation culture is, he says, one of the features of private equity firms that companies would be wise to treat with caution. "Companies can learn a lot from private equity, especially their sense of urgency and their focus on the fundamentals, but not all practices are appropriate in a company seeking sustainable long term value creation."

Musing on such issues, he begins to expound on the roles of chairmen, CEOs and non-executive directors. The cult that elevated CEOs to the status of movie stars has waned, which, reading between the lines, he seems to believe is no bad thing.

"The CEO has to set the company's direction but chairmen and non-executive directors all have a responsibility to ask awkward questions, the simple 'emperor-has-no-clothes' questions, especially on issues like remuneration. If we're not doing that, what are we there for? We're just adding to the cost of the business for no purpose."

In the late 1970s, Buchanan spent an eye-opening year seconded to the UK Cabinet Office's central policy review staff, in the twilight years of Jim Callaghan's Labour government. And it is to politics he turns to emphasize his point. "In the 1980s, Reagan and Gorbachev were trying to negotiate arms limitation. They were getting stuck and the two leaders went off for a walk to see if they could strike a deal. At one point, Gorbachev turned to Reagan and said: 'What's the matter, Mr. President? Don't you trust us?' To which Reagan replied: 'I believe in trust, General Secretary, trust with verification.' As a former chief financial officer, I'm a great believer in trust with verification." He then delves deeper into American history: "The founders of America knew what they were doing. People aren't perfect and, recognizing that, they developed a series of checks and balances. That's what any company should have."

Enron was, of course, legendary for its lack of

checks and balances. After all, if you're sure you're the "smartest guys in the room," why do you need them? Talk of that notorious corporate disaster brings one of Warren Buffett's dictums to mind. "I have a lot of sympathy with his view that you shouldn't invest in a business you don't understand," says Buchanan. "How many people, for example, really understand complex derivatives?"

Most of Buchanan's career has been spent in the oil industry, which he recalls with obvious affection ("You were always on the brink of an economic or political crisis of some kind"), but having qualified as a research chemist in the 1960s, he admits he has "been inspired by the motivation and dedication of people in the healthcare industry, who know they are making a real difference to people's lives."

Does he, I ask, have any words of advice for other managers? Or subscribe to a particular theory of management? He pauses for a moment to consider the question and shakes his head a little. "Business has changed so much. When I

started, there were no computers – well, there were huge mainframes, of course, but not in offices – and now there's a computer on my desk that has more power than the one in the command module for Apollo 11."

He does not believe there is a unified field theory of management. "I have learned from different sources, but a lot of management is so situation-specific it's hard

to generalize." Indeed, a discussion about whether management is an easily transferable skill – could Disney boss Michael Eisner, for example, lead a manufacturing firm? – ends inconclusively.

He is clearly much more at ease when I ask him what, as a non-executive director of some of the world's most famous companies, he looks for when appraising a business: "The style and tone at the top. You can tell a lot from the company leadership. If there's hubris, rather than humility, that's a warning sign. Consistency of message. Do you hear the same thing from the lips of staff as you do from the directors? Openness is always important – the degree of openness says a lot about a company. And you have, as a potential director or buyer, to get a sense of their ethics. Where would you put them on a scale that went from white to gray?"

The formal business of the interview now over, the photographer asks if he can take a posed portrait. "With a number?" quips Buchanan.

There's an enigmatic line on his résumé that says he has a wide range of cultural and social interests. I assume that, as he's from New Zealand, one of these interests is rugby. He nods.

"Cricket?" I ask.

He looks briefly forlorn and says: "Cricket and New Zealand don't really go together. A bit like England." With that joke and a handshake, he is off, back to his office and a fantastically tidy desk. ●

*"As a former CFO, I'm a great believer in trust with verification. And asking the awkward questions"*



#### BUCHANAN'S WAY

A Kiwi, John Buchanan is chairman of healthcare giant Smith & Nephew and an independent director on the boards of BHP Billiton, AstraZeneca and Vodafone. He has been listed by *The Times* as one of the 100 most powerful people in Britain.

After obtaining an MSc with first-class honors and a PhD in organic chemistry from the University of Auckland, Buchanan was awarded research fellowships at Wolfson College, Oxford.

He joined BP in London in 1970. In 32 years with the group, he was chief operating officer of BP Chemicals, BP group treasurer, chief executive of BP Finance and, from 1996 to 2002, group chief financial officer, a position he held during the merger with Amoco and the acquisitions of Arco and Burmah Castrol.

He was seconded to the UK Cabinet Office in 1976/77 to work for the central policy review staff, was a member of the UK Accounting Standards Board (from 1997-2001) and a non-executive director of Boots plc (1997 to 2003).



# IS THERE ANYTHING YOU CAN'T OUTSOURCE?

Businesses used to outsource what they do.  
Now they're outsourcing what they know

BY RHYMER RIGBY

Public holidays are supposed to be days of rest. In emergency rooms they are anything but. If you're unlucky enough to be one of the thousands who need an x-ray on Labor Day in the U.S., where one in five radiologist vacancies go unfilled, you might expect a long wait. What you might not expect is that your x-ray will be emailed to India, where it will be examined and diagnosed, with a suggested treatment returned within 30 minutes.

Teleradiology Solutions, the Bangalore-based medical consultancy which diagnoses hospital scans from the U.S., Africa and the Middle East, employs radiologists across the world to maximize its competitive edge – time. “A central hub of radiologists reporting for multiple sites is a very efficient way of delivering teleradiology to places where there is a shortage of talent, and the night shift can be easily covered by a daytime radiologist in another time zone,” says the company's co-founder, Dr Sunita Maheshwari. “In Singapore, we cut the turnaround time for a patient's x-ray reading from three days to one hour.”

Welcome to the world of knowledge process outsourcing (KPO). Fifty years ago we outsourced low-end manufacturing, then skilled labor, then business processes such as payroll. Now it's high-value work done by seriously skilled white collar workers. It is one thing to outsource the blue collar jobs of the toiling masses, but outsourcing the jobs of

wealthy, articulate professionals is risky. When these opinion formers make a fuss, people listen.

That said, there has been a steady trickle of news organizations – and even some US local newspapers – outsourcing journalism to India. And several merchant banks have realized that clever Hungarians in Budapest are just as skilled at company analysis as clever – and far more highly paid – Britons in London. Even the fabulously self-regarding creative industries are getting in on the act. Sometimes the driving force is cost. American video game designers know they can pay half the US\$7,000 (€4,490) per character fee if the graphics are created in China. In other sectors, the driver is a shortage of talent: a dearth of priests has forced the Roman Catholic church in Canada to have prayers said in India for churchgoers' dead relatives.

What KPO does, says Anand Aithal, co-founder and managing director of investment researchers Amba Research, is free up onshore knowledge workers to be more productive. “Companies use us to manage their surge capacity and more repetitive tasks so that onshore workers can do higher value work and have better personal lives.”

Aithal admits there are limits to what KPO can do. “People don't fire their knowledge staff and exclusively hire outsourcers because there are regulatory constraints and we don't have 15 years' experience in capital markets.” Even so, this level



**Fast food**

A Wendy's drive-thru in the U.S. saves five seconds per order by using a call center

**Online education**

Bangalore firm TutorVista remotely teaches 10,000 pupils in America



**Teleradiology**  
India's health  
imaging sector  
could double in  
five years, as  
the country's  
radiologists  
diagnose scans  
for Western  
hospitals who  
can't recruit

of outsourcing would once have been unimaginable. Technology is so cheap and fast that collaborating across continents is perfectly feasible. But the most important shift is a change in attitude.

"The view for a long time was that you can't break up a business's value chain," says Edge Zarrella, KPMG's Global Partner in Charge, IT Advisory. "But why can't you do it? Do you need everything at home? Of course you don't!"

Complaining about jobs going abroad is a cheap vote winner but it's not, Zarrella says, always

*"How far can you take KPO? An Asian client outsourced his CEO. Must your CEO be in-house?"*

accurate. "I'm based in Australia. Our last prime minister said we'd compete with India. Why would we? We can't. We're better off being good at KPO. There's no evidence everything is going to India."

Three of the world's big outsourcers – the U.S., U.K. and Australia – have unemployment rates of 5.0, 5.2 and 4.2 percent. By contrast, the rate in more protectionist France is 7.9 percent. Once the unemployment rate falls to 4-5 percent it is, practically speaking, full employment. That is, almost anyone who wants a job can get one.

And unlike business process outsourcing (BPO), KPO is a two-way street. Look at London. Firms from every corner of the globe use financial services there. And you rarely hear someone in Mumbai complain that they have to use a British merchant bank. Why would they? They use it because it's the best. Indeed, KPO in the West often prompts some of the developing world's most talented people to move to the developed world. In Silicon Valley, for example, 25 percent of firms have been founded by Chinese or Indian entrepreneurs.

When people think of outsourcing, they think big. And they think especially of India where industry analysts are happily predicting that KPO will grow by 40-50 percent a year over the next five years. But KPO works as well for smaller countries – in both directions.

Singapore is a small, rich island state with only one real resource: its people. It is surrounded by lower-wage economies – some with educated populations, some without – and outsources nearly everything. Early adopters of KPO, Singaporean businesses are masters of the art, even acting as outsourcing intermediaries for Western companies. Yet they are also outsourced to. "I've seen companies pull out of India and relocate to Singapore," says Zarrella.

Mostly outsourced to rather than outsourcing, Estonia has become one of the KPO capitals of the world by leveraging the fact that it is well educated, relatively cheap and near Europe. Estonians have cornered the world market in accountancy services and do high-end IT – both highly skilled but not dependent on scale. With strong cultural ties to western Europe, Estonia has nothing like the IP trust issues that China and India have.

"On BPO you can't compete with India and China, but anyone can do KPO," says Zarrella. "If you've got good people, just pick your niche and do it better than anyone else." Latin America could jump in here, especially as Argentina has gone from an incredibly expensive, well educated country to a rather reasonable one. Vietnam, with its first-world literacy rate, should also fare well.

But this rosy image of everyone happily doing what they do best is not the whole picture. Where does it end? If you can outsource the core, what is left? The view used to be that businesses that outsourced everything would be 'custodians of the brand.' But Zarrella's not sure: "You can outsource that too. There's no real reason to keep your strategy in-house."

"The danger with KPO is that you still need fantastic people in your company. If you outsource everything, it can be a very dangerous play. It's about opening your eyes to what you need to do."

If you outsource fairly routine tasks, such as your payroll, and decide, some years down the line, that it's not working, you could easily reinstate them. But outsource top-end functions – effectively your

**Number crunching**

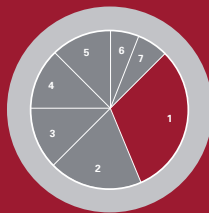
**US\$17bn**  
(€10.8bn)  
Estimated value of global KPO market by 2010

**71 percent**  
India's predicted share of market

**300,000**  
Number of people in India expected to be employed in KPO by 2010 – compared to 25,000 in 2005

**6**  
Hotspots for growth: Delhi, Mumbai, Hyderabad, Bangalore, Pune and Chennai

**How the KPO market will look in 2010**



- 1** Data search, integration and management: US\$5bn (€3.2bn)
- 2** Biotech & pharma: US\$3bn (€1.9bn)
- 3** Engineering & design; **4** Remote education and publishing and **5** R&D US\$2bn (€1.3bn) each
- 6** Animation & simulation services: US\$1.4bn (€0.9bn); **7** Others: US\$1.6bn (€1bn)

Source: Nasscom



**KNOWLEDGEABLE ABOUT OUTSOURCING**

Clockwise from top left: deadline-shy Douglas Adams outsourced his motivation to finish a novel; India's prime minister Manmohan Singh has every reason to smile, as it's predicted the country will take 71 percent of the US\$17bn (€10.8bn) KPO pie; Microsoft's Bill Gates has expanded the company's R&D operations in India with a US\$1.7 billion investment; KPMG's Edge Zarella believes there's nothing you can't outsource

Lew Robertson/Getty Images  
David Gould/Getty Images  
Sandra Baker/Getty Images  
Sean Gallup/Getty Images  
Peer Grimm/dpa/Corbis

organizational DNA – and you'll struggle to get them back ever. A department which has taken a decade to nurture, that performs a specialized or unique function, won't come back easily. No one is irreplaceable, but some people are much, much harder to replace than others.

You may lose something less tangible too: wisdom. You lose the accumulated years, familiarity, relationships and possibly your corporate culture. Getting rid of people who recall how things were done back in 1983 can seem a no-brainer until you have to deal with some odd legacy aspect of the company and realize that nobody has a clue. This is why you need to think hard about KPO. Is it worth it once everything is considered?

The transaction costs – the money and time spent finding KPO suppliers, negotiating with them and ensuring they deliver – are not to be underestimated, especially if you're outsourcing many different strands of the business. Security and confidentiality of information are concerns too.

In a sense though, KPO is part of globalization and, by and large, if it makes economic sense to outsource it, you probably have no meaningful choice. Simple demographics rule. Most developed nations have rapidly aging populations. The U.K. for example, has about a quarter of the graduates India has. What's more, India (where 32 percent of the population is under 15) will graduate more students who will work for far lower salaries.

"Demographics don't lie," says Zarella. "Employment in the West is still very high, but if

we don't have enough people, we don't have enough people. Look at what's happening in Japan: they were once very insular but now they've opened up to second generation Japanese who moved to South America."

Is any industry or discipline immune to KPO? Zarella thinks not: "It'll happen more in financial services, an early adopter that could be worth US\$5bn (€3.2bn) by 2010. But there's no sector you can't do it in. People ask me 'Do the Italians build Ferraris or not?' But that's KPO manufacturing."

What is certain is that KPO will profoundly effect corporate culture. BPO has removed humdrum and peripheral functions from the corporate orbit, but KPO chips away at what gives a business its very identity.

It's easy to imagine any non-IT business without an onsite IT department. But what about a fast-moving consumer goods business with no marketing department, a bank with no analysts or an ad agency with no copywriters?

Novelist Douglas Adams – who once said, "I love deadlines... the whooshing sound they make as they fly by" – effectively outsourced his motivation when he was locked in a guarded hotel room by his publisher for three weeks to finish a book.

This might not be a productivity solution the average business could apply, but it probably won't be the most surprising outsourcing story you'll hear. "How far can you take it?" asks Zarella. "All the way. I had a client in Asia who outsourced the CEO. Why do you need an in-house CEO?" ●



## Not rocket science

Managing IT spend can be complex – until you apply common sense

BY WALTER HALE

If, as a CIO, you're wondering why your discipline has gone from poster child to whipping boy, consider the maiden voyage of Ariane 5. It took the European Space Agency 10 years and US\$7bn (€4.5bn) to build the gigantic rocket launched from French Guiana in June 1996. And it took one software error – when the guidance system's computer tried to stuff a 64-bit number into a 16-bit space – to destroy the rocket in about a minute.

In extremis, that is the CIO's problem. Every company has its own Ariane 5: a mammoth project, with two thirds of the investment spent on IT, which over-ran, went over-budget and under-delivered. Often the simplest explanation is to scapegoat IT. Management may be entranced by the promise of transformational IT – tools that can help staff collaborate and innovate – but institutional memory of failure means CIOs often lack credibility.

This is a pity because IT may be the most complex management issue any organization faces today. IT is pervasive. The number of internal stakeholders far exceeds, for example, the number involved in supply chain management. The pace of change is remorseless, and accelerating, and there is a constant temptation for CIOs to 'go native' and obsess about technology. And since the dot-com bubble popped, fewer CIOs have the ear of the CEO. Typically, they now report straight to a CFO and define success as delivering savings.

A narrow, cost-driven approach to IT may look good on paper but Richard Bhanap, who leads KPMG's IT Strategy & Performance Practice in the UK member firm, says there is a downside: "You typically see what I call an 'extreme hedge

trimmer effect' – relentless, indiscriminate pressure to contain and reduce IT costs results in a tiny discretionary spend on IT." That might deliver easy savings that seem painless, but Bhanap says a broader view will be much more rewarding:

"To make sure that IT is creating shareholder value, KPMG firms' experience and evidence from the field suggests managers need to be able to give a convincing 'yes' to three key questions. Are we getting the most from our business as usual non-discretionary IT spending? Are we maximizing the returns on our discretionary IT investment, particularly by avoiding duplication or funding initiatives that don't deliver? Are our IT investments focused on strategic advantage, rather than just on efficiency and cost savings, or being frittered away on projects that won't improve business performance?"

Bhanap has worked with a multinational with an annual IT spend of US\$1bn (€640m). Two thirds went on 'business as usual' IT and a third was discretionary. By creating a central group to oversee and prioritize IT, and align it to business strategy, the company reduced overall IT spend by 5 percent, while raising discretionary investment – the spending that may make a real difference to performance – by nearly 25 percent and increasing shareholder value.

Creating a central group is not the same as building a centralized bureaucracy which shuts out other business units or stakeholders. But there is evidence that fragmentation in IT investment can inflate spending by as much as 40 percent. That's a saving any CIO (or CFO) would relish. ●

### THE POWER OF IT

Erik Brynjolfsson, director of eBusiness at MIT, says companies that consistently increase productivity through IT have seven traits in common:

- 1 They don't use much paper. Technology speeds up the company's metabolism.
- 2 Appropriate division of decision making: some centralized, others distributed to managers.
- 3 Strong performance-based incentives.
- 4 Lateral and vertical sharing of information.
- 5 Ruthless focus on business lines – unprofitable lines quickly discontinued.
- 6 Strong corporate culture so everyone is clear what the goals are.
- 7 More care and investment on recruitment, and more spent on training.

Creating a central group to oversee IT reduced overall spend by 5 percent and increased shareholder value

# accummen

## It's not all about **money**

Tesco's Andrew Higginson would like CFOs to focus on cash and strategy and worry less about bureaucrats

BY CAROLINE MARSHALL

**A**ndrew Higginson, the man behind the financial management and strategy that has made Tesco Britain's biggest, most profitable food retailer, once had a startling conversation with a manager newly promoted to the board: "Andy," he admitted. "I never realized you did so much." It was an odd comment from a long-term Tesco employee but not, Higginson believes, an unusual sentiment: "The biggest thing people don't get about the finance role is the scale and scope of bureaucratic regulation."

ASB, FRRP, IASB, ICAS, OFT, two FSAs... Higginson reels off an alphabet soup of regulators that represents less than a third of those requiring regular contact. "On a modern plc board the largest burden falls on the CEO and then, I'm convinced, it's the finance teams. I'm not one of those cranky people who thinks you should have no regulation, but these bodies are effectively excused the democratic process because they are set up as expert bodies staffed by so-called independents. We deal with a constant stream of clever, highly paid people who seem to have an awful lot of time on their hands."

Higginson, 50, is living proof of the CFO's expanding role in the post-Enron era. Though he is director of finance and strategy, he is no bottom-line-obsessed numbers geek – he has a finance team of over 1,000 to handle that. This allows him to help drive Tesco's global expansion, and, as it has evolved from a pure food retailer into selling, well, nearly everything, he has taken on many more roles, one being that of chairman of Tesco Personal Finance.

"My role is a broad-based business one rather than that of a technical specialist who just keeps the score. Everyone on the board is involved in strategy, but I pull it all together."

Before he joined Tesco in 1997, Higginson accumulated an impressive variety of experience.

Completing Unilever's commercial graduate trainee scheme, he took a two-year post as commercial manager of Lever Brothers China. Returning to the UK in the late 1980s, Guinness poached him to become finance director of its international division. He also worked in the clothing industry at Laura Ashley and the pre-merger Burton Group.

His four years at Laura Ashley as group FD taught him the essential skill of learning by the seat of your pants: "The company was going through a tough time and the banks pulled the plug on it twice. We had to draw up a refinancing strategy, which meant a traumatic shake-up. We had four chief execs in four years. I think we got the cash if not the brand issues right – you learn a lot in a situation like that."

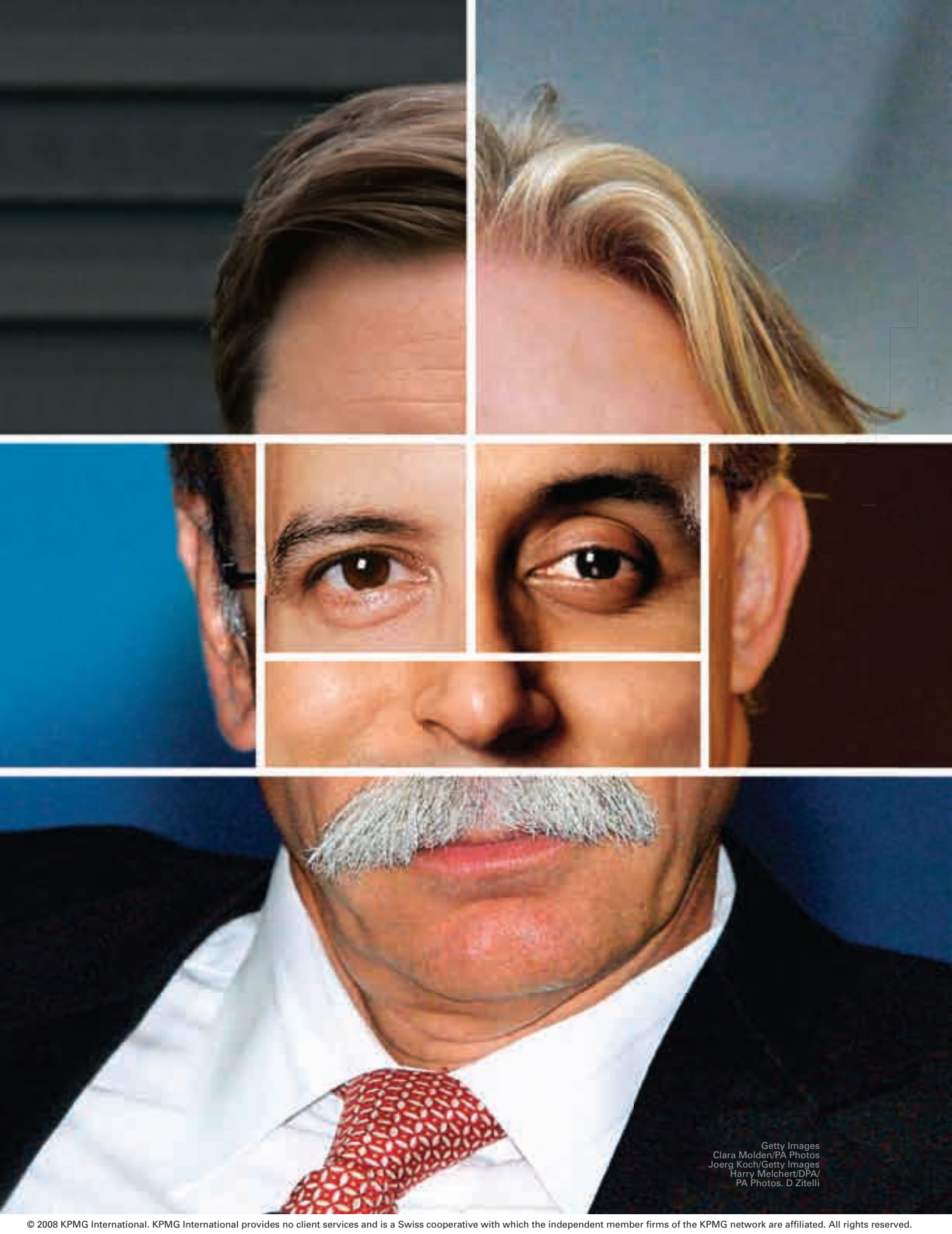
Much of what Higginson learned could apply to every CFO in a slowdown: "Watch the cash. All businesses live and die by cash flow. Try not to owe a little bit of money to a lot of people – owe a lot to a few so that you're important to them. Don't get in a position where you need emergency funding, especially at the moment when debt markets are closing. One of our problems at Laura Ashley was that the banks were indifferent to what happened to us."

A fan of *The Sun's* snappy soundbite approach to business news, Higginson loathes the deadly, ambiguous vocabulary that surrounds finance. "A big part of the job is to keep things simple," he says, citing Tesco's Build for Less programme. "We were trying to improve our return on capital but if I talked to people in terms of fixed assets on the balance sheet they'd glaze over. Talk about Build for Less and they get the fact that we build stores today for half the price of 1995."

No wonder Tesco has transformed itself from third-ranked supermarket in Britain to the third largest in the world. There's just America's Wal-Mart and France's Carrefour to catch now. ●



*"Watch the cash. Try not to owe a little bit of money to a lot of people, owe a lot to a few so that you're important to them. And don't get in a position where you need emergency funding"*



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# Management is obsolete and must be reinvented.

## Discuss

Is management guru Gary Hamel right? Can the Internet transform the way we manage? Three experts decide

BY PAUL SIMPSON

Revolutions sound inspiring but, as writer Richard Reeves notes, “they often end in stasis, bloodshed and despair.” So, is the call by Gary Hamel, the bestselling author recently voted the world’s top management guru in the *Wall Street Journal*, for businesses to reinvent the way they manage the start of a brave new era? Or would heeding Hamel’s manifesto to create ‘Management 2.0’ be a revolutionary error?

To debate Hamel’s revolutionary theory, outlined in his book *The Future Of Management*, we talked to three experts: Cary Cooper, professor of organizational psychology at Lancaster University; Soumitra Dutta, Roland Berger professor of business and technology at INSEAD business school; and Richard Reeves, consultant, biographer and writer for *Management Today*.

### Revolutionary ideas

Hamel argues that managers should focus less on bureaucracy, hierarchy, standardization and control and that business could use the Internet’s connectivity to decentralize, flatten management structures, give staff the means to become more creative and productive and improve decision making by making it peer-based (for a more detailed exposition of Hamel’s views see p24).

This might sound idealistic but Hamel argues that, in “an age of head-snapping change”, this shift

is a necessity. If companies are to flourish in the 21st century, he suggests, their competitive advantage will come from their ability to innovate, to generate and deliver creative ideas that give them an edge in the marketplace. To support his case, Hamel cites the example of companies like Google, Whole Foods and fabrics company W. L. Gore. No management theorist or CEO would honestly suggest that corporate structures we have learned to live with are perfect. And, for all the talk about the power of innovation over the last decade, they seem especially imperfect when it comes to transforming levels of innovation. Various studies have suggested that in most companies, anywhere between 75% and 95% of innovations fail. So Hamel has a point. Something must be done. But is using the power of the Internet the only way,

as he suggests, to “build a company that’s fit for the 21st century and fit for human beings”?

### The performance game

Hamel’s call will, says Dutta, resound with managers under pressure: “It is no longer sufficient to be good most of the time. They must deliver outstanding performance all the time in an increasingly demanding competitive environment. So managers constantly seek to improve performance and each call to reinvent management offers them hope for a new, possibly overlooked way to improve.”

But Reeves fears these competing utopias – and calls to emulate ‘hot’ companies like Google – may

prove a distraction: “Revolutions get our attention, but a better way to improve management might be a consistent, coordinated series of incremental steps. I find Jim Collins’ Level 5 leadership theory, which suggests there are different stages of leadership – and levels of maturity among leaders – very persuasive. The leaders he identified showed you can transform your company without being high profile. We often hear about companies like Google but Collins identified Darwin E. Smith as one of the great CEOs. This unassuming in-house lawyer turned struggling Kimberly-Clark into the world’s leading paper-based product company. For 20 years, he set targets, held people to them and analyzed the bowels of the company and you never saw him on the cover of *Fortune*.”

*“Each firm will have to craft its own Internet-enabled style of managing. Call it iManagement”*

## The great debate

Cooper says Hamel's goal, to make companies fit for human beings, is eminently sensible: "How many times have I heard a director say, 'People are our most important asset'? Companies must actualize that and compete on the quality of work they offer. It's in their interest to ensure a high quality of working lives, especially as they strive to improve productivity. A 2002 study by Harter, Schmidt and Hayes found that employees' sense of engagement and well-being predicted levels of customer satisfaction, profitability and employee turnover."

### The management challenge

But can the Internet reinvent management? Dutta isn't sure: "If management is about getting the best out of people, you don't need the Internet to do that. The right leadership can create the right culture to get the desired levels of creativity out of staff without it. But the Internet has changed management processes in one vital way – by expanding the scope of action and influence to include employees, customers, business partners and other stakeholders. Harvesting the creativity of millions will need new thinking and methods."

Like Hamel, Reeves believes the Internet will profoundly change the way we do business – "IT, Internet and email represent the single most important reiteration of work since the invention of electricity" – but says managers and organizations have not yet adapted to exploit the technology.

"So far, technology has just contributed to the intensification of work, partly because many companies and managers haven't changed their practices. The technology gives us the flexibility to make working lives more rewarding and to insist, as many managers do, that tasks be done at a certain time and place will soon seem Jurassic."

Dutta says change will come, but it will take time: "All technologies can be used for good and bad. The Internet can empower individuals but it can lead to stress and misuse for two reasons: organizations are still learning how to use it effectively, and it is always changing. Firms that have barely got used to email as a management and decision-making tool are now asked to handle social networking and all the accompanying features of Web 2.0."

Cooper says some bosses abuse the technology. "Email is a sterile medium that offers the perfect 'get-out' to avoid awkward one-to-one conversations. Some conversations must be face-to-face. Many of the communication cues we pick up are physical and social. You don't get that in emails, which are often badly written or misused."

He believes companies can only liberate staff through the Internet if they develop a whole new style of management: "We are used to managing by time and place, how long people spend in the office, but to exploit the Internet's power in a simple way – to let staff work at home when it is convenient and productive for them to do so – we have to manage by objective. We have to trust employees and that's more difficult, more complex and, initially, more time-consuming. Most managers just aren't trained to manage like that."

Reeves says the way firms use IT highlights the need for change: "Erik Brynjolfsson's work at MIT

### HAMEL IN SIX PARAGRAPHS

1 Traditional management was created to control large-scale organizations efficiently

2 Using the Internet, management can amplify human accomplishment, to get more out of individuals by giving them the appropriate tools, incentives and working conditions and to ensure that, together, they achieve more than as individuals.

3 Companies can use the Internet to enable individuals to connect and collaborate in real time, to amplify and aggregate creativity.

4 The management model which has driven the Internet's growth is non-hierarchical, horizontal not vertical, with thousands of leaders, tens of thousands of followers and rapid peer review.

5 By encouraging decentralization, flow of ideas and peer-based decision making, the Internet will change the way firms are organized, flattening management structures and reducing managers' need to 'manage'.

6 Firms that rely on old management methods will stifle creativity and fail to develop a competitive advantage.

Reprinted by permission of Harvard Business School Press. Adapted from *The Future of Management* by Gary Hamel. © 2007 Gary Hamel. All rights reserved.

shows IT investment can be wasted if it is not combined with simultaneous, aligned changes in organizational practice, HR policies and culture."

Hamel admits that not every CEO wants to hear how they need to revolutionize their organization, but he insists: "The Internet is making it possible to amplify and aggregate human capabilities in ways never before possible. Most CEOs don't yet understand how dramatically this will change the way companies organize, lead, allocate resources, plan, hire, and motivate—in other words, how new technology will change the work of managing."

But it isn't just CEOs who have doubts. Traditionally, business thinkers have been wary of any 'single issue' approach to management and it's not yet clear whether the Internet will kickstart a revolution or just enable organizations to improve and enhance traditional methods of management.

Cooper is sceptical about the Internet's ability to transform innovation. He agrees that it will help place ideas, as Hamel says, on a more democratic footing, but cautions: "Technology will not, by itself, overcome internal structural barriers." Businesses that excel at innovation often call it a close contact sport. Easy electronic access to data and colleagues is great but is the contact close enough?

Dutta says using the Internet to democratize decision making, making it more peer-based as Hamel suggests, won't suit everybody. "It can slow things down. I'm not convinced this process will change the quality of the decision but wider participation will help decisions become accepted. Participation is critical for fair process and for getting key stakeholders to accept the decision and its associated outcomes."

### The middle class

Hamel's call to flatten management structures, shrink middle management and decentralize met with a mixed response. Cooper is broadly sympathetic, arguing: "The management model shouldn't be a pyramid, it should be a square, with people from different disciplines cooperating as peers. And there are too many middle managers who just scrutinize what other people do and define their position by the size of their budget, office or the armies of staff reporting to them."

Dutta begs to differ: "It is not as simple as saying there are too many managers, it's rather that firms have not succeeded in leveraging the full potential of all staff. Organizations and managers are not very good at unleashing and leveraging creativity."

Reeves takes issue with Hamel on this. "Middle managers must be the last unprotected minority in the workplace. We all use terms like re-engineering and delayering but if you look at most businesses today, there isn't that much left to be delayed."

He cautions against generalizing about the quality of middle managers: "If you judge middle managers purely by productivity metrics, it's easy to underestimate their contribution. But when you get rid of middle managers you lose their collected wisdom and you don't notice that until a situation comes along and you realize that only they knew how to handle that particular client. Or only they have the experience of working through a recession

and can say 'Ah yes, this is just like the early 1980s, and back then we did this, this and this'. Once you lose that wisdom, it's very hard to replace it."

**Model behavior**

So does the Internet mean we must ditch the traditional hierarchical corporate model? Cooper isn't sure: "We are hardwired to think hierarchically, but those hierarchies could be simpler and people should have a clearer idea of how they affect their working lives."

Reeves worries that the Internet could encourage a one-size-fits-all approach to management: "It is wrong – and counter-productive – to impose hierarchies on free spirits. But it would be just as wrong to force everyone to become free spirits. Some people will want to become self-employed or portfolio employees who work for various companies. But many people are comfortable with hierarchies. For them, job satisfaction is working 9am-5pm, for a boss who prioritizes their workload, knowing that, if they do their tasks reasonably well, they're secure. There's nothing wrong with that."

Dutta says businesses do not fit Hamel's pigeonholes: "All organizations are centralized and decentralized. The Internet can decentralize decisions (such as to field sales forces) and maintain control (such as in centralized sales

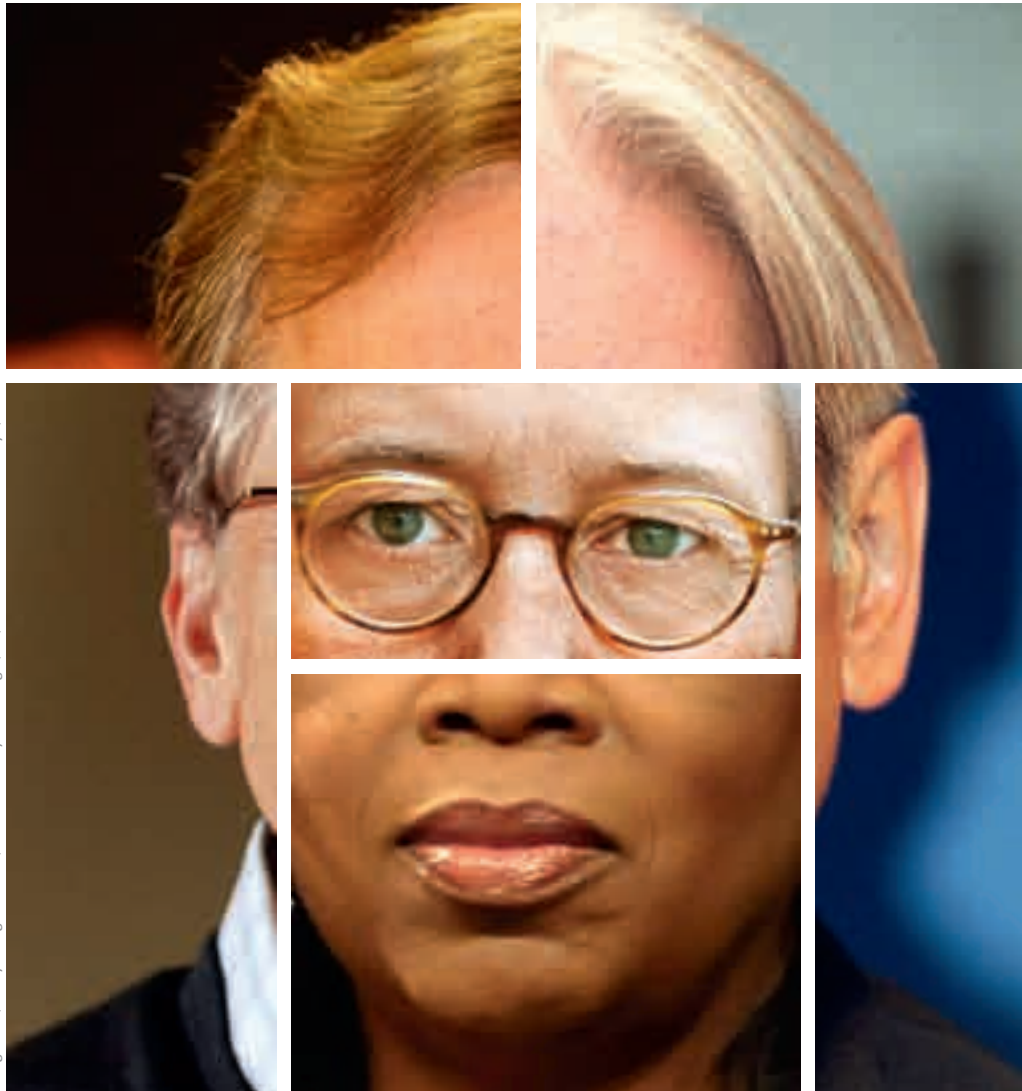
databases). Management must choose what to emphasize in which context."

"There is nothing new about notions of flat, decentralized and innovative organizations," says Dutta. "What is new is the pervasive and intelligent nature of the Internet. The scope and richness of the Web could change management and decision making. Organizations must quickly learn to decide which Internet-enabled possibilities make sense for their business model, customers, employees and stakeholders."

So Hamel is right to point to the Internet as an agent of revolutionary change. But revolutions, as Reeves says, don't always work out as their prophets envisaged and different types of organizations may still flourish.

Dutta concludes: "You can call it Management 2.0, but there is no one-size-fits-all version of Management 2.0. Each firm will have to craft its own: you can call it iManagement, or individualized management." ●

*“Middle managers must be the last unprotected minority in the workplace”*



Joerg Koch/Getty Images, UPPA/Photoshot, Myriam Vogel/AP/PA Photos, Tammie Arroyo/PA Photos



**DEBATING ISSUES**

Clockwise from top left: Gary Hamel, visiting professor of management at London Business School; Cary Cooper, professor of organizational psychology and health at Lancaster University; Richard Reeves, author, commentator and *Management Today* columnist; Soumitra Dutta, Roland Berger professor of business and technology, INSEAD. Hamel's book is called *The Future Of Management* (Harvard Business School Press). You can find more about Level 5 management at [www.jimcollins.com](http://www.jimcollins.com)

**PICTURE THIS**

Richard Reeves, Richard Branson, Dieter Zetsche, Arun Sarin, Soumitra Dutta, Marjorie Scardino, Bill Gates, Manfred Wennemer, Oprah Winfrey and Gary Hamel make up our composite pictures of a 21st-century business leader

# KNOWN UNKNOWNNS

Crisis, as JFK pointed out, is symbolized in Chinese by two brush strokes: one for danger, the other for opportunity. The skill is knowing the difference. These ten factors could change business life as we know it

BY MICHAELA BUSHELL, RHYMER  
RIGBY AND WALTER HALE



**1**  
**The car industry**

Forget the gloomy headlines, most carmakers are optimistic about the future. But then with global car ownership rising by 5 percent a year, they should be.

Competition in the U.S. and Europe may be fiercer than ever but sales in China, India, Brazil and Russia are booming. And the industry is finally making cars that are kinder to the planet which people want to buy.

Take the developing markets first. Investment in the Chinese car industry has been so huge that China may buy as many cars as the U.S. by 2013. The advent of cheap cars like Tata's Nano – which costs US\$4,100 (€2,600) – for these markets may revolutionize the industry. The Nano is no fluke: 660,000 new Ladas were sold in Russia last year. Toyota may launch a US\$7,000 (€4,400) car there while Renault, GM and Ford are developing low cost cars.

The industry can prosper by sourcing alternative fuels and selling affordable hybrids. Over 500,000 alternative fuel/hybrid vehicles were sold worldwide in 2007. Sales will soar as hybrids become cheaper and 'flexible fuel' engines using ethanol or petrol are developed. Greener diesel will gather momentum.

Instead of fighting emissions targets, some carmakers welcome tougher rules, believing once they know what they have to do, they can get on and do it.

**2**  
**Chinese wages**

The world's most populous nation is running out of labor. The legacy of the one-child policy, aging population (see graph) and an economic miracle leave Chinese leaders facing the stark prospect that its factories have all but exhausted the massive pool of rural migrant labor.

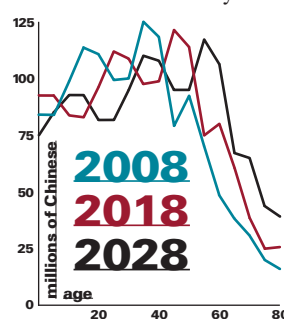
Firms planning to offshore in China should reconsider their labor costs. Wages are rising most in eastern regions – 2.8 percent in 2004 and 11.5 percent in 2006, according to the Chinese Academy of Social Services – but the trend is moving inland.

More than six out of 10 rural workers earned over US\$85 (€55) a month in 2006. Chinese wages are still 25 percent lower than in Mexico, but how long will that competitive edge last?

In response, some Hong Kong investors have already relocated factories from Guangdong to cheaper Vietnam, while the Chinese government is trying to ameliorate the crisis by spreading development into rural areas.

The skills shortages are worrying for Chinese firms too. They need to adopt international accounting standards but China has 69,000 accountants when it probably needs 300,000.

This isn't just China's problem. Merrill Lynch economist T.J. Bond warns that: "A sudden increase in Chinese wage inflation would be a major risk for the world economy."



Source: U.S. Census Bureau



**3**  
**Big pharma's big problem**

CEOs of pharmaceutical firms should ask themselves: can they handle the truth? Big pharma's patents, which can produce margins of 90 percent on a drug, are running out. Drugs generating US\$42.8bn (€27bn) of revenue have fallen out of copyright in the last two years. Typically, it now costs US\$1bn (€630m) to develop a new drug. Allowing for inflation, the industry spends twice as much on R&D as it did a decade ago to develop 40 percent as many drugs. And soaring public health bills mean the cost of drugs is under scrutiny.

But big pharma can still prosper if it raises productivity and rethinks its approach to R&D, which accounts for 17.1 percent of corporate spend.

Firms should shift the research base east, making real, not token, use of Asia's growing, cheap R&D expertise. But strategies must change too. The old ways – extending existing drugs, hunting new blockbusters, setting out to invent new molecules – may be less fruitful than focusing on the pathology of diseases.

Open innovation could help. Millennium Pharmaceuticals has collaborated its way to the top: 31.6 percent of its US\$525m (€333.6m) 2007 revenues came from royalties. By embracing open innovation, big pharma can cut costs and transform productivity. It's a lot more constructive than firing CEOs.

Michael Grimm/Getty Images, Lauren Nicole/Getty Images



**4**  
**A pandemic**

In the last five years, 234 people have died from the H5N1 strain of avian flu. David Shotton, a bioinformatics expert at Oxford University, warns that if H5N1 became easily transmittable between humans the fatalities “may far exceed the 67 million deaths caused by the Black Death”. Luckily, a vaccine to fight H5N1 was approved in the U.S. last year and flu vaccines may slow its spread.

But planning for a pandemic is not alarmist. In 2003, an outbreak of Severe Acute Respiratory Syndrome in rural China spread so fast that commerce in Hong Kong and Beijing was halted, trade fairs across Asia were cancelled and Singapore’s GDP shrank by 1 percent.

In a Chase Cooper pandemic simulation last autumn, more than one in three U.S. companies had no continuity plans. Firms that planned extensively kept going in the short term, even as absenteeism hit 49 percent.

So the advice is plan and plan well. You won’t plan in vain. If it’s not bird flu, it’ll be something else. An IBM study of global risk found that, from 2002-2007, 62 percent of companies with sales of at least US\$5bn (€3.2bn) suffered a major risk event and 42 percent were unprepared. One in six experienced a risk related to the environment or health. Firms which were well prepared were more likely to have their CFO owning risk-management and ran integrated, standardized, financial processes across the company.

**5**  
**Carbon fiber**

Light, versatile and effective, the composite known as carbon fiber is so popular that demand may soon outstrip supply. Consultant Anthony Roberts predicts that, at a bare minimum, global demand will reach 35,490 tonnes in 2008. That’s so close to the 2007 output – 40,516 tonnes – that many big manufacturers are trying to accelerate planned increases in capacity.

Carbon fiber’s high strength-to-weight ratio appeals to makers of cars and planes seeking to save fuel and reduce CO<sub>2</sub> emissions. Demand from the aerospace industry for fiber is expected to grow by 80 percent by 2013. The launch vehicle from Axon Automotive, the first new mainstream British carmaker in 50 years, is made of carbon fiber. This composite is also in demand to make wind-turbines (which could use 30,000 tonnes of fiber by 2016), storage tanks for compressed natural gas, oil exploration platforms and skis.

Seven manufacturers – Cytec, Hexcel, Mitsubishi Rayon, SGL, Toho-Tenax, Toray and Zoltek – control 70 percent of the market and with their investments, fiber capacity should increase by 78 percent in the next five years. But that may barely keep pace with sales. This is good for the industry – Toray’s operating margins on its carbon business are 20 percent – if not for customers. So expect more investment in recycling, still in its infancy, and, if technology lowers barriers to entry, new players, possibly from China.



**6**  
**Poles apart**

Poland rejoiced when it won the right to co-host football’s 2012 European Championships. But the road to 2012 is complicated by the fact that 3 percent of its roads meet EU standards.

A lack of decent motorways isn’t Poland’s only challenge. Inflation is high (4 percent), the World Bank ranks its bureaucracy as only the 74th most efficient in the world and so many Poles retire early that only 54 percent of the potential workforce are in work. A shortage of urban housing and complex renting laws make it easier for a Polish plumber to move to Germany than within Poland.

Prime minister Donald Tusk needn’t worry too much. Growth is slowing – but still at 6 percent this year – and unemployment has sunk from 14 to 8 percent.

Euro 2012 is merely the most dramatic proof of Poland’s charisma for foreign investors. A new merger market survey in association with KPMG International suggests Poland’s private equity market has grown sixfold since 2005 and many firms now rate Poland a better, safer bet than Russia. And they’re not backing plumbers, but biotech, pharma, healthcare and IT. Direct foreign investment in Poland hit US\$19.2bn (€12.3bn) in 2006.

Tusk’s next big deadline is 2011, when Poland is due to join the Euro. To do that he’ll need to cut the tax burden on wages (a single flat tax has been mooted) and curb public spending.

**7**  
**Business travel**

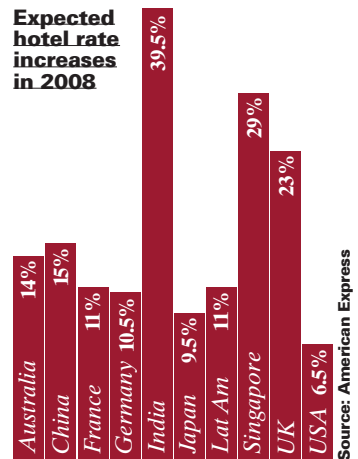
Teleconferencing has never looked better. Soaring fuel costs and a business travel boom have led to predicted rises of up to 8 percent in air fares and 14 percent in hotel rates this year.

Greater competition under the Open Skies Accord may temper the airfare hikes, but the liberated airlines will head to Heathrow, so expect London hotels to impose more minimum stay requirements.

Airlines will fight for your custom with flat-bed seats, better food and internet access, though sitting by someone discovering the joy of free international calls online will not please all fliers.

The bad news for weary road warriors is that more firms will audit their travel spend and use travel management agents to obtain every discount they’re due. But any realistic appraisal of travel costs must include the effect on staff productivity.

The best way to trim cost is not to travel. Cisco, which has sold 360 teleconferencing systems to Procter & Gamble, says it has cut travel expenses by US\$150m (€95.6m) by using its web-based conference technology. Cisco is biased but those figures will intrigue CFOs across the world.



8

## Cyber espionage

“For many companies cyber espionage is the elephant in the room,” says Martin Jordan, KPMG in the U.K.’s principal adviser on IT security. “Many are too embarrassed to talk about it: the scale is monumental.”

In November 2007 MI5, the U.K.’s domestic intelligence service, warned 300 CEOs that their IT systems were at risk from foreign intelligence services: at least 100 countries are known to engage in cyber espionage.

A favored form of cyber spying utilizes fake ads on web sites, inviting employees to click on a link inadvertently introducing a ‘custom Trojan’ to their laptop which feeds back confidential data from behind company firewalls. Blended threats use different types of attacks to hit several vulnerable areas at once. Areas of interest to intelligence services range from chemical formulae to negotiating stances in international trade deals.

Some businesses run a separate system for commercially sensitive data. That’s good practice but an attack on your accountants, suppliers or customers can be nearly as painful. “Traditional IT defences do not protect you,” says Jordan. “Often even large software vendors don’t know about these exploits, let alone the anti-virus companies. You must protectively mark your most sensitive info, ensure it is secure and assess what information you share with business partners.”



9

## Green IT

Here’s some rare good news on climate change: greening your IT is good for your image and your bottom line. IT systems typically account for a third to half of a company’s energy use, but Hewlett-Packard say making IT more efficient could lower operating costs by 60 percent.

PCs waste nearly half their power, but three-quarters of a computer’s environmental cost is generated in its production. Servers often waste a third of their power, so virtualization – where the under-used processing power of one area is tapped into by another – is a new buzzword.

As around 2.2m tonnes of discarded electronic goods end up in U.S. landfills each year, many states have toughened up rules on e-waste. In response, 14 companies – including Panasonic, Sharp and Toshiba – have formed a group called MRM to collect and recycle electronic products.

CIOs must regain control of businesswide IT purchasing, explain how green IT benefits every stakeholder and get tough. It can’t be long before firms are assigned a carbon allocation.

CIOs must also monitor IT R&D. Can Fujitsu’s laptop case made from corn work? Is Nokia’s Remade mobile, made from recyclable and renewable parts, more than a gimmick? And is thin client computing – basically a computer without a hard disk drive which uses less power, more economical to make and easier to maintain – the greenest solution of all?

10

## Control freaks need not apply

*Open innovation could transform your business*

Few would have expected a man with a background in cookies, travel and consumer credit to save the world’s biggest maker of mainframe computers from running out of cash. But that was the fate facing IBM in the early 1990s as it grappled with the personal computer revolution. What Lou Gerstner (pictured below) grasped was that what had become obsolete was not IBM’s technology, but its insular corporate culture.

In one of the great corporate resurrections, Gerstner turned IBM inside out. No company, he stressed, can do it all. Today, IBM is the chief evangelist of open innovation – the radical idea that companies buy or license processes or patents from other firms to solve particular problems in their own R&D.

The closed, vertically integrated model of innovation began to falter in the early 1990s when the Bayh-Dole Act in the U.S. transferred the ownership of intellectual property in new inventions and discoveries from the agency providing the funds to the institute and researchers doing the work. This mobilized entrepreneurial energy throughout industry.



IBM’s flirtation with disaster at the hands of closed-model managers taught the company three things: that building a better business model has a bigger and more lasting impact than being first to market; that you don’t have to originate the research to profit

from it; and that you can benefit from selling, or even donating, intellectual property you don’t need.

Since the term was coined in 2003 by Henry Chesbrough of the University of California at Berkeley, the evidence that firms can create profitable new ideas by tapping into the ‘wisdom of crowds’ has been sufficient for Xerox, BMW, Philips, Unilever, Henkel and countless others to follow IBM’s lead.


But open innovation is not for everyone. Relying on the wisdom of crowds works best when problems and solutions are both distributed and narrow in focus – in other words, much like Wikipedia. When market demands change continually, are vague or even unknown, open innovation isn’t so useful. It might be better to rely on your ‘internal markets’, where various solutions can be pitted against one another.

Open innovation is a two-way street: you have to give as well as receive. Managers need wholly new attitudes about ownership – control freaks need not apply. Ultimately, open innovation means relying on partners who can do the job better than you. And that is hard for a lot of firms to swallow.

*Nick Valéry writes a weekly column for the online edition of The Economist*



Croesus Receiving a Tribute from a Lydian Peasant, 1629 (Oil on Canvas), Vignon, Claude/Musee des Beaux-Arts/Giraudon/The Bridgeman Art Library



# Can cash management make your company as rich as Croesus?

Sadly not. But it can unlock capital, transform your bottom line and safeguard your future in uncertain times

BY PAUL SIMPSON

Every time the price of gold soars, you should ask: is your company managing its cash properly? You can't manage it as badly as Croesus, the rich, smug king of Lydia from 561B.C. to 546B.C., pictured accepting tribute from a peasant. Assuming his revenue stream would never dry up, he let guests take home as much gold as they could carry and paid for his hubris, losing his throne in battle.

Not being as rich as Croesus, most businesses are more cautious. But in good times, firms seek growth and profit. A sustained rise in the price of gold, often a precursor of higher interest rates, is a useful warning that the business cycle is reaching a point where turnover is vanity and cash is sanity. But this change is a great opportunity. Between 2003 and 2005, KPMG member firms helped 30 companies, with turnovers ranging from US\$51m (€31.9m) to US\$14bn (€8.9bn), release US\$2.2bn (€1.4bn) in funds just by changing the way they managed cash.

Mick McLoughlin, global head of restructuring at KPMG and partner in the UK firm, says: "As the economy slows, those funds could give businesses a competitive edge, so they may not have to do all the

usual things firms do when they fear recession – slash R&D spend, trim marketing budgets, lay off staff. In tough times, companies that generate cash are well placed to acquire at bargain prices.

"There's nothing new about reducing the amount of capital locked up in a company. But this has often been subordinate to other objectives, such as sales and profitability. Because of that, the potential for improving cash flow often remains under-utilized."

To leaders inspired by the 'vision thing' cash management can sound like a laborious, complex task, involving huge IT spends. Not true. Simple steps can produce simple gains. Here are eight factors to consider as you focus on cash.

## 1. Lead like Warren Buffett

If your CEO doesn't think cash is important, neither will other managers, no matter how vocal your chief financial officer is. Andrew Ashby, restructuring director at KPMG in the UK, says: "Good cash management can uncover hidden process inefficiencies across the business, but if you don't get buy-in from every department, you will only find out about problems when they become

## Best practice

too obvious – and expensive – to ignore.” How good you are at managing cash is partly driven by the caliber of information at your disposal so every department – from sales to manufacturing to that subsidiary you recently opened in Taiwan – should get with the program.

Warren Buffett’s businesses generate cash because he has made this drive part of their corporate culture. He invests in easy to understand firms that have what he calls a ‘moat’: something that gives them a clear advantage over others and protects them against competition. But he only buys a business if it has the right projected cash flow per share over five years, and advises managers that sometimes the obvious thing to do with cash is the wrong thing: “Often it’s a mistake to invest money where you’ve earned it. Truly great businesses, earning huge returns on tangible assets, can’t reinvest a lot of their earnings internally at high rates of return for an extended period.”

### 2. Think like a private equity firm

Used to buying indebted businesses, private equity firms spend the first 100 days of an acquisition estimating how much cash they can generate without hurting the business. This isn’t just to pay off debts, it’s about improving working capital to grow the business’s value on a three to five year plan.

Much of what private equity firms do is obvious – like tightening up on receivables or extending payment terms – but their focus makes it easier to spot units generating marginal amounts of cash – perhaps a pet project of the ex-CEO – and shut them. New ventures have to meet tougher criterion on cash generation to get the go-ahead.

### 3. Choose your technology wisely

The spreadsheet’s day is over. Treasury information systems help firms draw on and study a wider range of data to forecast more accurately, improve financial reporting and make better decisions. But Ashby says choice and sophistication come with a risk: “Firms sometimes find new systems don’t make that

much difference to their cash management. That may be because the technology isn’t right for their business, and staff can’t use it properly.” Many technology solutions are sold with a fine array of features and benefits, and a promise to repay their cost in a year. But usability is key. If the system is so complex staff have to be reminded, cajoled and threatened to use it, you just waste money.

Managers can rationalize procrastinating about cash management by arguing that the perfect integrated information system isn’t on the market yet though its release – as is usually the case – is imminent. Debtor listings, contract reviews and robust cash flow forecasting can all enhance liquidity and don’t require you to spend a cent on IT.

### 4. Learn the black art of cash forecasting

Before the industrial revolution, entrepreneurs usually had a precise grasp of what was coming in, going out and when. If they didn’t, they went bust. In a fast-moving, globalized economy, accurately answering those questions is much harder. That’s why so many companies turn to cash forecasting.

The bad news about cash forecasting is that you are likely to get it wrong. Every company’s future is partly a tale of the unexpected, so cash forecasting can never be a science, just a subtle art. But you can reduce the margin of error. Forecasts often fail because the appropriate stakeholders are not engaged and

*“If you don’t get everyone’s buy-in you’ll only discover problems when they are too expensive to ignore”*

held accountable for reviewing the accuracy of their inputs and documenting their assumptions. Finance departments are too stretched to resource the task properly, or take so long finding data that they can’t study it carefully. If the data comes from your enterprise resource planning system, emails, spreadsheets and conversations, you may struggle to drill down deep enough to find out why a specific forecast was wrong and rectify the flaw.

Cash flow forecasting is so complex that Dr Mark J. Garmaise, assistant professor of finance at the UCLA Anderson School of Management in Los Angeles, says 40 percent of firms centralize forecasting: “That way a small number of employees at HQ can focus all their time on forecasting, becoming expert at managing new techniques to generate superior forecasts in less time.”

Centralization has drawbacks. Garmaise says: “The forecaster is remote from necessary local information. Transmitting local information can be difficult

## Kings of cash

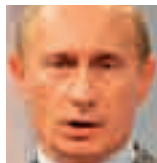
*A monarch, a president and a CEO show how it’s done*



1135

**Henry I**

The last English king to die with no debts until the 1500s, Henry I (1100-1135) revolutionized the state’s accounts by launching the exchequer.



1999

**Vladimir Putin**

In 1999, debt amounted to 70 percent of Russia’s GDP. With rising revenues, 66 percent has been repaid and US\$120bn (€77.4bn) cash kept for future use.

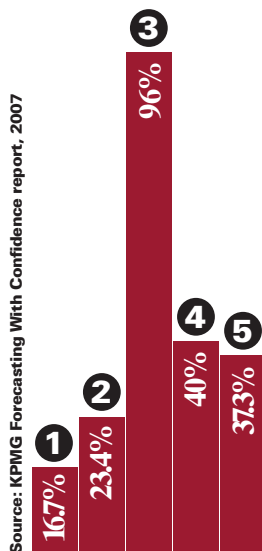


2007

**Warren Buffett**

The sage of Omaha has US\$64.2bn (€41.1bn) in the bank. Shares in his Berkshire Hathaway business are worth 50 times as much as in 1968.

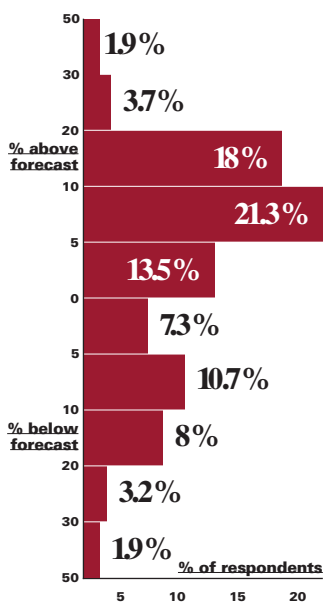
Stefano Blanchetti/Corbis, Ralph Oriowski/Getty Images, Alex Wong/Getty Images



**WHAT TECHNOLOGY DO YOU USE WHEN PREPARING FORECASTS?**

- 1 Specialist accounting software
- 2 Bespoke forecasting/planning tools
- 3 Spreadsheets/manual processes
- 4 Enterprise resource planning systems
- 5 Off the shelf forecasting/planning tools

**HOW RESULTS COMPARED WITH FORECASTS**



**FURTHER READING**  
To receive a full copy of KPMG's *Forecasting with Confidence* report, email [agenda@kpmg.com](mailto:agenda@kpmg.com).

because 45 percent of firms still receive data verbally." And it is important business managers have a stake in the forecasts. But central forecasting makes sense for multinationals as they usually centralize cash management to earn more interest.

**5. And encourage brutal honesty**

Cash forecasts – let alone business forecasts – are too crucial to be clouded by internal politics. A 2007 report on forecasting, prepared for KPMG International by the Economist Intelligence Unit, found that only 1 percent of the 504 firms surveyed met their business forecasts. Most under-forecast, believing this to be cautious and appropriate, but if you're too conservative you may fail to meet demand. Some 44 percent of respondents believed pressure to match forecasts to targets made them less accurate. Forecasting correctly is hard enough. If staff feel obliged to manipulate data to fit head office preconceptions, it becomes impossible.

**6. Supply chains can't take all the strain**

"In the old days, some companies thought improving cash flow was as simple as writing to suppliers to inform them you would be extending your terms of payment," says Ashby. "But just squeezing your supply chain can be dangerous."

So dangerous, it could kill your business. In 1994 the U.S. company Aris Isotoner tried to save money by closing its Manila factory and outsourcing the manufacture of 27 million gloves and slippers to third party suppliers elsewhere in Asia. Sales halved as quality plummeted, deliveries became less timely and production costs actually increased by 10 percent. By 1997, Aris Isotoner had incurred operating losses of US\$123.6m (€78.4m) and was sold by its parent, Sara Lee. So if you want to squeeze more cash out of your supply chain, don't dictate to suppliers, work with them.

**7. Less paper, more technology**

Cash is king but checks and banknotes don't help cash flow. Electronic payments speed delivery of money and, by paying promptly and electronically, you should be able to negotiate lower prices with suppliers. Energy utilities use dynamic discounting by offering consumers a small discount on their next bill if they pay quickly. Most firms plug electronic card payments into treasury information systems, so it is easier to spot anomalies.

The shift to electronics can yield real dividends. In 2000, one U.K. business found it was missing the chance to bill for US\$2.75m (€1.75m) of sales a day because it was posting proofs of delivery to clients. It soon switched to electronic versions.

**8. Stick with it**

Cash flow management isn't a short-term fix for firms at risk, it can be the discipline that drives the growing value of a business. "Those that are very good at this – like Mittal Steel and Buffett – have a cash culture," says McLoughlin. When Mittal bought a Mexican steel mill in 1992, it instituted a daily meeting where heads of department discussed costs and volumes the previous day, instilling a discipline and focus mill managers would never forget. ●

# Why investors have become so obsessed by cash

When Cadbury Schweppes CEO Todd Stitzer revealed last year that his company would spin off its beverage business and return the cash to shareholders, the investment community was delighted. Fast forward to spring 2008. As the demerger was completed, Cadbury announced it would keep the cash. Investors were taken aback, but given the enormity of the U-turn, complaints were few and muted. Most thought the company was right to be prudent in these uncertain times.

Cash can be king or leper, depending where you are in the business cycle, and the Cadbury episode shows how fast attitudes change.

When debt is cheaper than equity (i.e. when a company pays less in interest than in dividends to shareholders), it makes sense to use debt rather than share capital to meet the company's needs. The easiest way to do this is to borrow money – and use any reserves of cash – to buy in and cancel some of the company's shares. The market mantra investors love here is an 'efficient balance sheet' – where the mix of debt and equity keeps the cost of capital as low as it can be.

But just as your mortgage becomes a millstone when interest rates rise, so it is with companies. If sales disappoint and the warehouse fills with unsold goods, or resurgent inflation adds to costs that can't be passed on, a highly indebted company can fast run out of cash. With no buffer against bad times, they soon struggle to pay the interest. The private equity buyouts of 2006 and early 2007 are top of most pundits' lists of businesses most likely to run into financial trouble in the coming downturn.

That's when debt becomes as unpopular as last year's fashion craze. Investors who had been urging companies to gear up now worry about them going bust. They rush to sell the shares and switch to businesses that are cash rich and better placed to cope with the tougher times.

The longer a downturn persists, as stories accumulate about how tough it is out there, the more risk-averse investors become. It can get to the point where nothing else matters but cash. Survival is the dominant instinct, fear the main emotion.

It can stay that way for a very long time. But when conditions do improve, investors rediscover their sense of adventure, favoring companies willing to invest to exploit the upturn. Companies slow to sense the change of mood, which hold on to their cash, can be derided as unadventurous and sleepy.

Often companies with a reputation for good cash management are those where it is so second nature they don't even talk about it. Tesco and WPP are run by managers who treat every penny as their own, so they know exactly where it is, why it is there and whether it is overdue.

Similarly Rolls-Royce, after going bust nearly 40 years ago, has built its business model so the cash needed to build a jet engine is offset by the income stream from servicing those already installed.

Most businesses are not like that. They would like to be, but in good times things get a bit complacent, and they get a rude awakening when the marketplace suddenly gets tough.

That's when management relearn the sobering lesson that there are few things more uncomfortable in life than having a desperate need for cash and no idea where to find it.

*Anthony Hilton is city editor of The London Evening Standard*

# foresight

## Can algorithms improve your recruitment?

BY MORICE MENDOZA

"I am not a number!" was the mantra of *The Prisoner* in the cult 1960s TV series. Forty years on a new online survey ranks people on a scale of one to 100 according to their suitability for a job. It won't surprise anyone that the company doing this is famous for its algorithms – Google.

Previously, Google recruited using billboard ads in which complex mathematical challenges led to a webpage for applications, or through online ads that popped up if you searched for an obscure topic of interest to Google. It could then take two months to put candidates through interviews, which, Laszlo Bock, vice president of people operations at Google, admits, are "a terrible indicator of performance."

Now Google sifts applications for suitability to the company, rather than a specific job. To measure this, staff were surveyed to find the attitudes, behavior and traits good employees shared. Questions about skills and experience were accompanied by such offbeat queries as: 'What pets do you have?' Bock says: "It's not unusual to bump into dogs in our office. Maybe dog owners have a personality trait that is useful."

The answers were matched against 25 measures of employee performance, including 'organizational citizenship' – things you do that aren't part of your job but make Google a better place to work – to create a score that reflected a fit to the company's culture. It revealed success didn't always correlate with the school grades Google valued so highly.

Online surveys are a new recruiting tool. The methods behind them aren't. "Pioneers thought they could discover ability through phrenology – examining the bumps on your head," says employment specialist Richard Donkin. Psychometrics – testing to measure abilities,

attitudes and personality – is still popular, but can be simplistic. "Someone with the extrovert personality needed to close a deal may be deficient in what's needed for after-sales service," Donkin says.

Top firms such as BP and Marks & Spencer have a list of competencies and behaviors key to their industry, such as robustness in the face of continual change. Microsoft likes to challenge interviewees with questions such as 'How do you move Mount Fuji?' to test for cultural fit. But with many recruiters finding, like Bock, that interviews, grades and CVs are poor predictors of performance, some firms go to extremes. In Russian 'stressovoyes' – stressful interviews – applicants are insulted and have water thrown at them to uncover their true character and, therefore, their leadership style. Many employers – including the C.I.A. – now use social networking sites to recruit or carry out background checks.

Would Google's recruitment approach work for senior executives? Rob Bailey, head of R&D at psychometric company OPP, says it could, as part of a range of methods. "With executives, it's not all about fitting company culture. It's about a person's strengths and weaknesses." In the main, you're looking for the trait that may derail their career.

A mechanistic approach to selection runs the risk of failing to future-proof. Google needed entrepreneurial people during its spectacular rise, but next it may need steady types, to manage what has been created. "Ask yourself what skills and attributes you'll need in five years," says Bailey, "and make sure you don't recruit clones." ●

"It's not unusual to bump into dogs in the office. Maybe dog owners have a personality trait that is useful"



### RECRUITMENT BY NUMBERS

Google progressed from using equations in job ads like this to using equally complex calculations to assess applicants

# An entirely avoidable scandal

What the mismanagement behind Watergate can teach every boss

BY PAUL SIMPSON

You can look at Watergate two ways: as a massive, bafflingly daft scandal that ruined a president, or as an everyday tale of corporate mismanagement, in which an ill-conceived head office initiative (essentially ‘Let’s stick it to the competition big time’), flawed decision-making processes and human psychology combined to let an overzealous middle manager ruin the organization.

Gordon Liddy proposed raiding the Democratic Party’s Watergate HQ in March 1972 to uncover insider info. Liddy was deemed flaky by many in the White House. The burglary cost US\$250,000 in untraceable cash and relied on the absolute discretion of 10 men. No wonder Jeb Magruder, one of three managers who approved the plan, later moaned: “How could we have been so stupid?”

**Groupthink** When the break-in was mooted, President Nixon was high in the polls and his jubilant aides were victims of what Yale psychologist Irving Janis dubbed ‘Groupthink’ – when a group is more worried about maintaining consensus than making rational decisions. Symptoms include illusions of invulnerability, unquestioned belief in moral superiority, direct pressure to conform or be accused of disloyalty, stereotyping dissenters as weak or stupid, self-censorship and ‘mind guards’ who shield the group from data that contradicts its assumptions. In any book about Watergate, you find all these symptoms in abundance.

**Reject then retreat** The break-in may have been approved because Liddy’s request fitted what Bob Cialdini, author of *Influence: The Psychology Of Persuasion*, calls the ‘rejection then retreat principle’ – familiar to anyone who’s experienced a budgeting process. Suspecting head office will, on principle, trim any budget request, we ask for more than we need. In previous meetings, Magruder and Nixon’s attorney general John Mitchell had rejected costly, wild schemes involving kidnapping, violence and prostitutes. Liddy returned with a cheaper, modest proposal, so they agreed. “No one was overwhelmed with the project,” Magruder said. “After starting with the grandiose sum of US\$1m, we thought US\$250,000 would be acceptable.” Liddy benefited from what Cialdini calls “perceptual contrast”. Compared to the earlier sum, the smaller one seemed reasonable.

**Mutual concession** Mitchell said he and Magruder felt “we should leave Liddy a little something.” For Cialdini, this was the crux of their error. “In many social interactions, we start with demands that are unacceptable to each other. It is socially beneficial for these incompatible desires to be set aside to promote compromise. One way we do this is by mutual concessions. Once someone has made a concession we feel obliged to reciprocate.”

Our need to reciprocate is so strong that, in the 1970s, when an American professor sent Christmas cards to complete strangers, most sent one back. So Magruder and Mitchell approved the break-in. A third manager, Frederick LaRue, initially demurred, saying it wasn’t worth the risk. He missed earlier meetings and could, Cialdini says, “see this proposal for the clunker it was and react objectively.”

**Defensive reasoning** Management theorist Chris Argyris says our natural drives to be in control, to win, suppress negative feelings and behave as rationally as possible create a defensive mindset which in an organization “often leads to skilled incompetence that produces escalating error and self-fueling, self-sealing processes.” That sums up Watergate. Asked why the administration broke the law to win an election it couldn’t lose, Mitchell said: “It was Nixon’s mode of operation and personality that did for him.” An open, participatory problem-solving process might have prevented the burglary or the ensuing cover-up. As Nixon’s involvement in the cover-up – he wasn’t aware of the burglary in advance – forced him to quit, his management style cost him the presidency.

**The importance of dissent** Magruder and Mitchell’s approval was stupid but understandable. They won’t have wanted to cross Liddy: his party trick was to hold his hand in a candle flame until it started to burn and he had the ear of Nixon’s closest aides. Cialdini says: “Any dissenting opinion – even if it’s stupid – improves the quality of decision making, so you should solicit dissent, not penalize it.” A few dissenting voices in Nixon’s White House might have spared him – and America – much agony. ●



## LESSONS IN LEADERSHIP

Read more about Watergate in *Breach Of Faith* by Theodore White. Irving Janis explores ‘Groupthink’ in his book of the same name, while Bob Cialdini’s theories are found in *Influence: The Psychology Of Persuasion* and online at [www.robertcialdini.com](http://www.robertcialdini.com)



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