KPMG

Issue 4, Oct/Nov 09

Agenda

Insights into growth, performance and governance

Thriving in chaos
How mining giant Vedanta profits from low prices

Political economics
What nobody is telling you about the return of big government

Reducing risk
Ten ways you can learn to expect the unexpected

"If I wrote my memoirs, the title would be: It's Not About The CEO"

Stora Enso boss *Jouko Karvinen* on the power of great teams

AUDIT ▪ TAX ▪ ADVISORY

“Opportunities are back on the menu.

Most companies have been through the “Are we okay?” stage. Some businesses are still embroiled in the battle to remain viable, but the vast majority have shone a light into every dark cranny, done all the prudent, sensible housekeeping and can now ask: what opportunities will present themselves and what are we going to do about them?

We have relearned the art of managing in a recession. The next step is to ensure we are ready to ride over any remaining bumps in the road – and, more importantly, to prepare for renewed growth.

This edition of *Agenda* includes a number of thoughts on the road to recovery, including advice on managing change and the uncertainty of how governments will play their roles. Opportunities, rather than crises, are becoming the order of the day.”

Alan Buckle
Global Head of Advisory, KPMG

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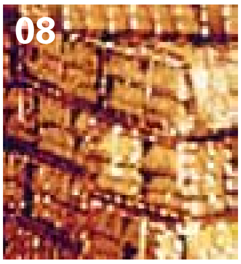

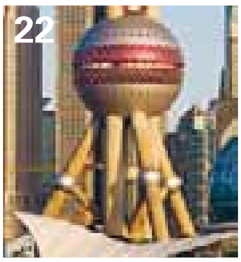

MUST READS

Moviestore Collection; David Short; Dirk Anschultz, Dougal Waters, Image Source/Getty Images

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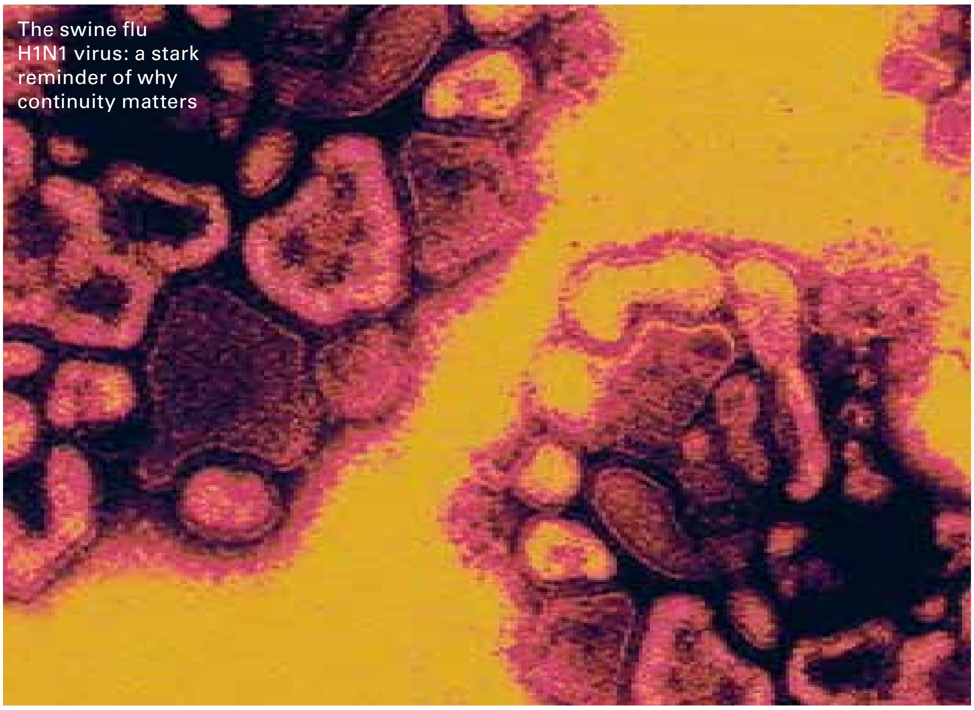


Ready for anything?

Business continuity gets serious in the face of a pandemic

In June, the scale of global alert surrounding swine flu was raised to level five by the World Health Organization (WHO), just 42 hours after it had reached level four. Experts had expected such a hike to take around a month.

With some businesses still contemplating orders for anti-bacterial handwash, the news highlighted the fast-moving and devastating threats they face. Business resiliency experts iJet said only 57% of multinationals had a pandemic preparedness plan in place by the time level five was reached.

The potential cost to business is huge. Last year, The World Bank estimated that a flu pandemic could cost US$3 trillion (€2.1 trillion) and trigger a 5% drop in global GDP.

Business continuity planning used to mean being ready in the event of a terrorist incident or serious power failure but, says Will Brown, KPMG in the UK's head of business resilience, companies should factor in everything from pandemics to concerted cyber-attacks. "The current crisis means our appetite for risk is lower than ever," he says – and that's why continuity is becoming a C-level concern. "There has been a fair amount of scaremongering in the mass media about swine flu, but it is one of the emerging threats focusing people's minds. Organizations are taking the risk process more seriously."

It is easy to be daunted by the variety of threats and the speed with which they change. Brown says that rather than just run a multitude of complex scenarios, companies should focus on two key factors: how many staff and/or buildings would need to be inactive before operations were seriously affected, and how long it would take to recover from such a situation. They should agree on what level of business activity a board expects in a pandemic. They might also want to ask the same of the key players in their supply chain.

"Businesses should undertake an impact analysis to understand the time frame they could be out of action, and the points at which that would have a significant impact. The aim is to develop a resilient organization that can withstand anything – from a pandemic to a local problem," he says.

CMSP/Getty Images; George Hammerstein/Corbis

Buzzword bingo

Jargon you really don't want to hear in your workplace

Architected
Invented verb, a more pretentious way of saying "designed"

Baked-in
Automatically included

Blue ocean
Unexplored market space

Negatron
The employee who always looks for the fly in the ointment

North of
More than, especially referring to cash flow

Polish the cannon ball
CEO-speak for "just do a good enough job"

Shoot the puppy
Take an unpopular but necessary action

Super-black
The ultimate secret

Toxic accountability
Too much of the wrong kind of accountability

Gender agenda

Male-only boardrooms may be missing out: research by Catalyst found that, between 2003 and 2007, the Fortune 500 companies with the most women on their boards enjoyed equity returns 53% higher than those with the fewest. Norway has led Europe by stipulating that 40% of directors must be female by 2010. Spain aims to reach that target by 2015. Yet only 0.2% of Japanese firms have a woman on the board and a quarter of European company boards have none at all.

Who moved my management theory?

Business authors name the next big thing

Gary Hamel reinvented management and Michael Hammer re-engineered the corporation. But where will management theory go after the credit crunch? We asked four leading commentators.

Kieran Levis

Author of *Winners and Losers*

"What enabled Apple, Sony, Amazon and Google to create new markets was the same as it was for Henry Ford and George Eastman: distinctive organizational capabilities that meant they could make compelling propositions to customers... the key is having the ability to continue to do better what the business already does well."

Gary Cokins

Author of *Performance Management*

"The new focus is planning and analytics. Change at all levels has accelerated so much that reacting after-the-fact is too late and risky. By measuring and analyzing what truly matters, management's job could be less stressful."

Anders Drejer

Aarhus School of Business, Denmark

"The financial crisis will lead to more holistic and dynamic management theories. We are realizing that an organization has several bottom lines and that innovation as well as corporate social responsibility should be included to secure long-term survival. We will see management theories that make this more operational."

Henry Mintzberg

Author of *Mintzberg on Management*

"I hope that the next big thing in management will be no big thing, but rather a recognition that management is a basic human activity that isn't helped by what is fashionable."

microtrend

Industrial commons

Can Western nations avoid losing their manufacturing base? Experts have called for an 'industrial commons'. The term, spinning off the concept of 'common' or publicly owned land in English law, refers to a collective R&D, engineering and manufacturing capability where business and government can nurture know-how, people and manufacturing ability. Sharing IP isn't new, though opening up other areas of business will be a trickier sell. But governments may prefer to encourage this if it stops manufacturing vanishing to emerging economies.

leading edge

Growth? Don't get me started on that...

Matthew Gwyther, editor of *Management Today* magazine, says if companies are to move on, they will have to look to internal sources while the market remains so unpredictable

We don't know where we are yet

So is the global economy patient off life-support, into the recovery room and on the way to finding its way back onto its feet? It's hard to tell just yet, because the modest improvements in financial markets and confidence levels follow such enormous declines. Calling the bottom requires some nerve.

This crisis is global and severe in its nature

This is highlighted by the performance of equities. The capitalization of global stock markets has rebounded from a low of US$29.8 trillion (€21.3 trillion) in March 2009 to US$41.5 trillion (€29 trillion) in July. This is a big jump; however, it still leaves capitalization way off its US$63 trillion (€45 trillion) peak of October 2007. Despite recent gains, the loss of wealth has been severe – an enormous volume of blood has been lost – and the body business is severely anaemic.

CFOs are cautious – with good reason

The early stages of an economic recovery are a delicate business and a tricky time for the board of any company. This means that although other board members – those who innovate and who wish to take stuff to market – may be straining at the leash to get back into growth mode, most CFOs will remain highly cautious.

The appetite for risk is healthy

This period is probably one of the most nerve-wracking for many a CFO because it means re-entering the world of risk, even though the rules aren't as straightforward as they were before the crash. There is no doubt that it is the bold who will reap the rewards: while competitors are still inward-facing and fretting over costs, it is the right time to strike.

Credit where credit's due

Many companies will discover that even though they may have the appetite for risk and wish to make a strategic move that requires investment, the capital simply won't be available. Green shoots need the rain of available finance and at the moment, even when lenders reluctantly ease open the sluice, the rates of return they seek are unrealistically high. (Even the AAA-rated UK government – which next year is proposing to spend four pounds for every three it receives in revenue – is finding it tougher to place debt.)

It is wrong to rule growth out of the equation

Growth may have to be organic and from within. This could involve the unpleasant task of canning less successful projects to free up resource for more promising enterprises, or a redeployment of troops, rather than a recruitment campaign. Firms can only move when the buying public is ready. It's always worth remembering John Maynard Keynes's words: "The markets can remain irrational longer than you can stay solvent."

What's on their 'to do' list?

These five leaders have a challenging role to play in the world's most exciting emerging economies. What can you learn from them?

01 MARTIN ROMAN

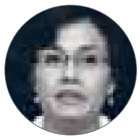
39, CEO, Czech energy firm CEZ Group

The economic downturn won't beat the head of CEZ Group, central and eastern Europe's biggest power business (a conglomerate of 96 companies) – as long as he survives election turmoil.

The story so far Martin Roman joined CEZ as CEO in 2004, after five years running engineering group Škoda Holding, and has fast turned the national giant into a major player. Acquisitions in eastern and central Europe and the decision to focus on nuclear power have paid off: Q1 2009 profits, up 23%, beat most forecasts. With Czech households and firms feeling the downturn, Roman ditched planned price hikes for an offer to lock in 2009 prices until 2010.

What's next? In the run-up to Czech elections, the correlation between rising household bills and bulging executive bonuses at the 70% state-owned company has become a political battlefield. Roman persuaded the EU it would be "economic suicide" to force firms in this coal-dependent region to pay full price for CO_2 emissions from 2013. CEZ still wants to buy high-return projects within its geographical territory and is investing more than US$5.5bn (€3.8bn) in coal generation in the Czech Republic.

He'll succeed if… He convinces the incoming government to back him and the public that he's not a profiteer. Czech customers don't move to rival German supplier E.ON. Tighter trade standards open up paths to the West.



02 SRI MULYANI INDRAWATI

46, minister of finance, Indonesia

Ex-IMF executive director and USAID consultant, Sri Mulyani Indrawati has quickly made her mark as Indonesia's finance minister, since being appointed in 2005 by President Yudhoyono. Her success in stamping out corruption, cutting debt and attracting foreign direct investment has prompted *Forbes* to call her the world's 23rd most powerful woman.

The story so far When she took over as finance minister, Indrawati fired the heads of the notoriously corrupt tax and customs divisions. Indonesia is still ranked as quite corrupt (126th of 180 countries), but, as she says: "We started from an empty glass. Now it is 60% full." Foreign investment has soared, while her 'sunset policy' on tax delinquency has boosted tax receipts by 50%.

What's next? Indrawati predicts economic growth accelerating to 7% from 2011. If this growth proves, as she believes it will, to be sustainable, Indonesia – already the largest economy in south east Asia – could qualify for inclusion among the BRIC economies. Indonesia's GDP grew 4% in Q2 2009, outperforming Russia and Brazil in the same period. Indrawati has vowed to lift the stimulus package to the G20's recommended 2% of GDP but plans to keep debt at 32% of GDP. A deal with Japan should ease the currency fluctuations that disrupt her forecasts and the government is looking to open new markets to FDI.

She'll succeed if… Interest rates and prices, especially of rice, remain stable. Infrastructure investment pays off. She can cut admin costs – still around 15% of public spending. She stops Chinese manufacturers dumping goods and clamps down on smuggling.

Go further

Find out more at: *www.cez.cz/en/home.html*; *www.depkeu.go.id*; *www.orascomtelecom.com*; *www.foxconn.com* and *www.zain.com*

03 NAGUIB SAWIRIS

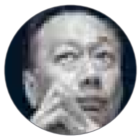
55, CEO, Orascom Telecom

Egypt's first multinational, Orascom Telecom, has a reputation for conquering the markets others steer clear of, such as war-torn Iraq. A loud critic of China's refusal to "play fair" with foreign firms, CEO Naguib Sawiris has set his sights on an even tougher market: North Korea.

The story so far Set up in 1998, Orascom Telecom is the largest wireless operator in the Middle East. Willing to invest in an untapped market, Sawiris launched North Korea's first mobile network in 2008. He doesn't believe in the approach many other telecom giants have adopted to global branding: "As a foreign investor, you're at a disadvantage, why make it worse by having a foreign brand?," he says. "We've created the perception that our company understands the culture in each market." But net profit for Q1 2009 fell 66% and a court ruling means a rival company could buy Orascom's 35% stake in Egyptian wireless leader Mobinil – if it is willing to pay 80% more than market value for the shares.

What's next? If the Mobinil sale cash arrives, Sawiris plans to expand in the Middle East (he has just struck a deal with the Lebanese government), Asia (he's set to acquire in the region but has been thwarted in attempts to launch in China) and Canada. But the biggest challenge remains North Korea.

He'll succeed if... He gets North Korea to relax high taxes on handsets. The expansion into African markets pays off and he cracks China.



04 TERRY GOU

58, CEO, Hon Hai Precision Industry

Hon Hai Precision, better known by trade name Foxconn, is a rags-to-riches story. Founded in 1974 by workaholic Terry Gou to make TV switches in a garage, the Taiwanese group is the world's largest contract electronics maker, mainland China's biggest manufacturing exporter and, *Business Week* says, the world's second most powerful IT firm.

The story so far Gou's low-cost, high-speed model has won contracts with most leading brands in computing, communications and consumer electronics. With its proprietary eCMMS model, a trail of acquisitions and a diverse product range, Hon Hai kept revenue growth above 50%. But at the end of 2008, the company posted its first annual decline in net profit since 1991.

What's next? After lowering costs and boosting R&D spend, Gou continues to aim for 30% revenue growth this year. With 80% of production in coastal China, labor costs couldn't be much lower unless it was moved inland, and Hon Hai makes a third of its own components, so it can undercut rivals. A number of new industrial developments should help stave off rivals in mainland China. With clients reluctant to depend on one manufacturer, the focus is on R&D and service revenue.

Hon Hai files more patents in Taiwan than any other company and after opening an R&D centre in China stands to benefit from stronger ties with the mainland. Gou has begun looking for managers to devolve power to: "I want to sit back and give young people more responsibilities, when I'm still young".

He'll succeed if... He keeps broadening services' scope, moving up the value chain and into new markets. His team copes when he takes a back seat.

"If you try to make management a science, you will end up treating people as machines"

05 DR SAAD AL BARRAK

54, CEO, Zain

Having set himself the goal of getting Kuwait's first mobile operator into the world's top ten by 2011, Dr Saad Al Barrak isn't wasting time.

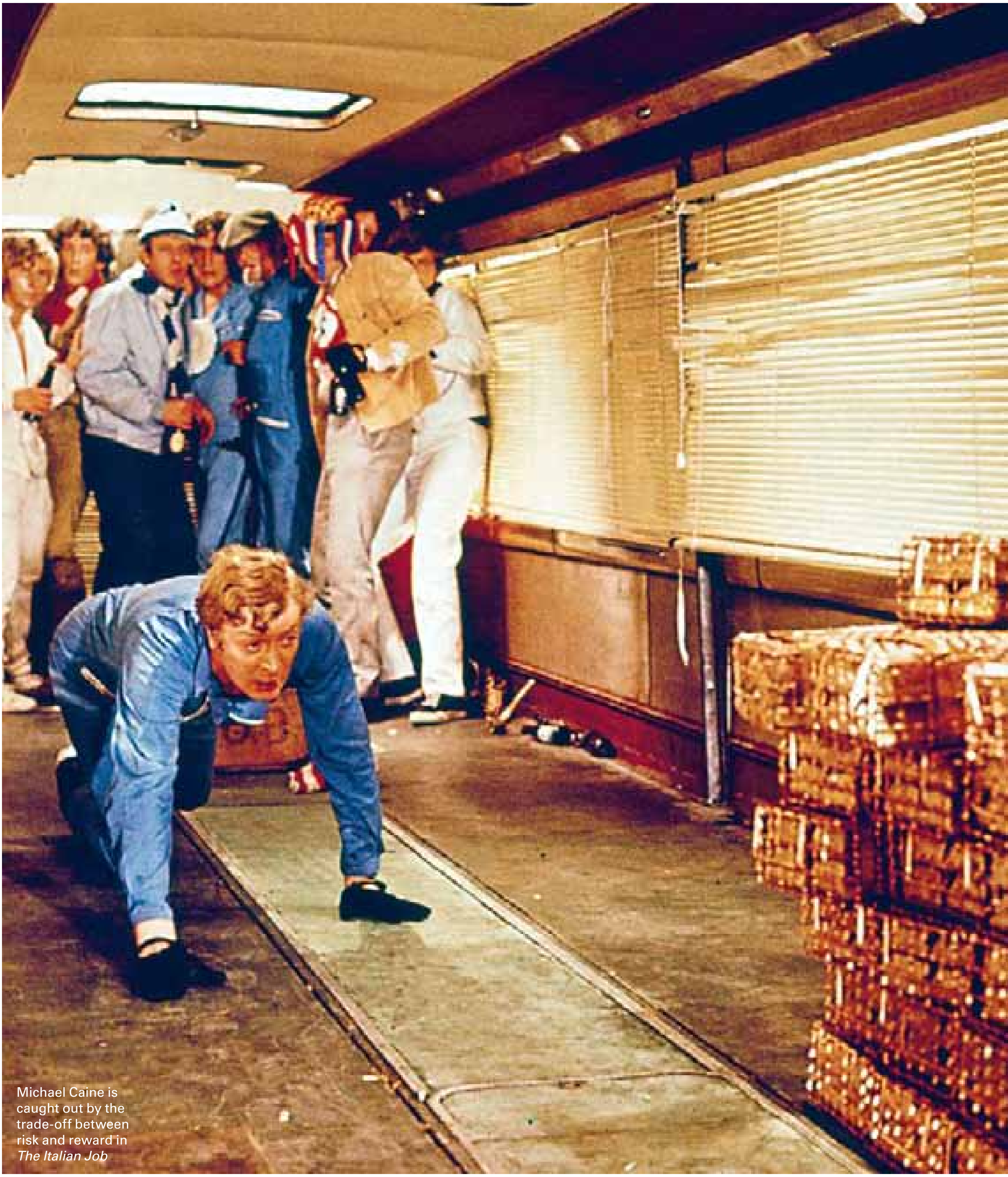
The story so far A former systems engineer, Al Barrak transformed IT group ITS before becoming Zain CEO in 2002. He launched an expansion strategy targeting global presence, 150m customers and an EBITDA of US$6bn (€4.1bn) by 2011. Describing his management style as "chaos by design", he has a hands-off approach to business units: "If you try to make management a science, you end up treating people as machines," he says.

Al Barrak has tried to replicate Google's people-centric culture. But Zain began 2009 with Drive11, a cost-cutting plan to shed 13% of the group's 15,500 staff. In six years, Zain has grown from a single operator in Kuwait to a commercial presence in 24 countries. In Ghana last December, Zain launched the second 3.5G mobile phone service in Africa. Its One Network mobile platform, which has eliminated roaming charges, helped 2008 net profit rise 6% to US$1.2bn (€850m).

What's next Al Barrak says Drive11 will cut costs by 5% in 12 months. He has earmarked $5bn (€3.5bn) for acquisitions before 2011 and expects net profit to rise 20% this year. Money transfer service Zap, which includes a partnership with Western Union, will allow customers to pay bills and bank through their phones. The big question is whether he accepts bids for Zain's African business.

He'll succeed if... Zain stays at the forefront of mobile broadband, expected to enjoy revenue growth of 188% in the Middle East by 2014, and money transfer. Operating costs stay low and he convinces investors about the African business.

Maurice Tsai/Landor,Kirst Wigglesworth/Press Association



Michael Caine is caught out by the trade-off between risk and reward in *The Italian Job*

Moviestore Collection

THE RISK BEHIND EVERY REWARD

A healthy attitude to risk should encourage sensible growth and prevent financial implosion. Can the errors of the recent past show us a new way forward?

BY RICHARD NORTHEDGE AND PETER BRADLEY

Risk management is in the dock, accused of partially precipitating recession. Yet paradoxically, the magnitude of the crisis has taught many companies one salutary lesson: those who fail to grasp that every reward comes with a risk attached – and misunderstand that risk – are in trouble."The credit crunch has highlighted not only financial risks – but all risks," says Oliver Engels, an internal audit, risk and compliance services partner based in KPMG's German firm. "One reason we had the credit crunch was companies measuring liquidity risk, credit risk and operational risk – but not all the other risks."

For René Stulz, chair of banking and monetary economics at Ohio State University, it is too simple to blame the discipline of risk management: "The fact that an institution makes an extremely large loss does not imply that risk management failed or that the institution made a mistake."

After studying the collapse of Long Term Capital Management (LTCM), the U.S. hedge fund rescued in 1998 by a US$3.65bn (€2.61bn) Federal Reserve bail-out, Stulz notes: "The only argument one could make is that managers took risks they should not have, but that is not a risk management issue as long as the risks were properly understood. Rather, it is an issue of assessing the costs of losses versus the gains from making large profits." Stulz points out that top management held large stakes in the big U.S. banks that collapsed recently and had every incentive to avoid taking risks knowingly – but still their institutions went under.

He identifies half a dozen mistakes companies commonly make: relying too much on historical data; focusing on narrow measures; overlooking knowable risks outside the normal risk classes; overlooking concealed risks; failing to communicate and not managing in real time. On the big question – how do you prepare for the next crisis? – Stulz urges companies to take a leaf out of the disaster management handbook: use scenario analysis to understand the ways a crisis might unfold, and plan how you would respond to each.

Stulz says risk managers should not rely solely on statistical models: they must think about how crises could unfold. "Such a scenario requires economic and financial analysis. It cannot be done by risk management departments populated only by physicists and mathematicians."

One concept whose time may finally have come is enterprise risk management (ERM). Mike Nolan, global head of risk and compliance for KPMG and partner in the U.S. firm, says the old worry – that it was hard to gauge ROI on ERM programs – is no longer valid. He says there are plenty of quantifiable ERM outputs: decreased variability in financial results, as well as reduced hedging and capital costs. "Used proactively, ERM can help avoid the risk management failures that precipitated the current crisis," he says.

The obvious thing to do – appoint a risk manager – can, Engels warns, be damaging if it means others no longer feel responsible for risk. "You need a person called a risk manager for binding things together. It does not have to be at board level, but the risk manager should have direct access to the CFO or CEO. At some companies, the job is too far down the food chain."

As risk management moves up the agenda, it could overburden companies. Engels warns: "A lot of companies have risk, compliance, internal control and internal audit – so you have four risk assessments. That's wrong." He proposes a single assessment that looks at risk in terms of each of the requirements, with each function being represented on the risk committee. "It's longer and more cumbersome to do it for all four, but it ensures nothing slips between the chairs." He says a narrow approach to risk management contributed to the credit crunch. "Companies did what was necessary for regulation, but nothing more. They did a compliance exercise, but not so as to challenge their own business."

Here are ten steps which can help companies better focus on risk. They will be most effective when considered in unison. Risk management can help to lower the cost of capital and open up new profit opportunities, but only if all your efforts are coordinated under one strategy.

1 Adopt a champion

If companies fail to consider risk, they cannot manage it. Who takes responsibility is crucial. Appointing a risk manager is not the whole story. Stulz says: "If risk is everybody's business, it is harder for pockets of risk to be left unobserved. And if employees' compensation is affected by how they take risks, they will take risk more judiciously."

Someone must accept ownership of risk and that person must be on the board – or directly answerable to it. Engels says: "Responsibility for risk has to be with those who take business decisions." That said, in a recent Economist Intelligence Unit/KPMG survey of executives, only 30% think their organizations spend enough time discussing risk at board level. In most companies surveyed, chief risk officers play no role in strategic initiatives. Half the businesses have no risk committee and don't intend to appoint a director with risk experience.

If Texaco had taken a risk management approach to its bid for Getty Oil, it might have been spared bankruptcy. Getty agreed a deal with Pennzoil in 1984. Texaco stepped in and won the battle for Getty – but it lost the war. Pennzoil was awarded US$10.5bn (€7.4bn) in damages; and in 1987, Texaco filed for Chapter 11 protection.

2 Adopt a strategy

Risk can be avoided, reduced, mitigated or accepted. Organizations should consider their risk tolerance before deciding how to cope with it. While some will accept none, others will find different degrees of risk acceptable. Tightening procedures or changing activities can reduce risks, but some can be offset by hedging, insurance or sharing with partners. Given that the current crisis took most people unawares, businesses worldwide are wondering how to identify the next big risk. KPMG's research suggests that big risks often emerge from within, as a direct consequence of management actions.

Charles 'Tex' Thornton was a young Texan entrepreneur who expanded a tiny microwave company into Litton Industries, one of the most successful high technology conglomerates of the 1960s. Making selective acquisitions, Litton grew at an explosive rate. But it began to buy larger and more troubled firms in industries it barely understood. The failure to monitor its own risks triggered a downward spiral and, in 2001, it was acquired by Northrop.

All change equates to risk: the trick is to create a more self-aware corporate risk culture. However, having assessed a threat, some executives will choose to accept it. "A lot of our firms' clients identify a risk but, as a conscious business decision, take it," says Engels. "That's good. That is what risk management is about: it's not about *not* doing things."

3 Identify your risks: internal, external, systemic

Risks come from all directions. It may be weather, demographics, competition, process failure – or risk from pricing, hedging or leverage. Sometimes the threat from within – a careless, disgruntled or dismissed employee – is greatest. In 2007, nine Trusts of Britain's National Health Service lost 168,000 patient details. In 2008, French regulator la Commission Bancaire fined Société Générale US$5.7m (€4m) for shortcomings in its control systems and internal procedures leading to tardy identification of rogue trader Jérôme Kerviel – a failure that cost the firm US$6.9bn (€4.9bn).

One internal lesson of the banking crisis in particular is that traders' risk was not aligned with their employers'. Stulz describes this as a 'concealed' risk: desk traders receive a significant share of any profits they generate, but don't have to defray their losses, so they are encouraged to assume risks.

Such misalignments trouble Nolan, who urges companies to look out for the moment "strategy looks in one direction but incentives encourage movement in a different direction". As risks develop, companies should constantly align and realign the linkages between the array of activities they undertake, Nolan says. The rising dangers of systemic risk – banks unable to lend, a collapse of consumer spending, swine flu preventing staff travel – are a challenge, because they rarely fall within the remit of one regulator. The current crisis suggests effort should be expended at a macro level. Extensive scenario analysis, as recommended by Stulz, may help tackle systemic risk.

4 Measure the risk accurately

Entrepreneurs are usually optimists, but often see the worst when assessing potential dangers, says Engels. "People tend to be more risk-averse and to exaggerate the risk propensity. But if that deters companies from growth, it is as serious a failure as underestimating risk."

Stulz says statistical techniques work when risks are known, but points out there was no historical data for house prices falling when sub-prime lending was high: "In such a case, statistical risk management reaches its limits and risk management goes from science to art."

Sometimes, the historical data can lead firms to overestimate risk and forgo revenue. In the 1930s, MGM initially turned down the movie rights to the bestseller *Gone With The Wind* on the grounds that, as producer Irving Thalberg told studio boss Louis B Mayer: "Forget it, Louis, no Civil War picture ever made a nickel." The box office records of previous U.S. Civil War epics proved Thalberg right. But *Gone With The Wind* still went on to become the biggest-grossing movie of all time (when ticket prices are adjusted for inflation), raking in US$1.22bn (€860m) in today's money, 32% more than *Titanic*.

5 Don't ignore risks

Never turn a blind eye to a risk just because it is hard to evaluate. A bad assessment is better than none, but more consideration – or a new approach – might allow better measurement. Stulz says if risks are ignored, they are not monitored and large organizations can expand in unmonitored areas – with dire results. Samsung's diversification into cars in 1995 coincided with an economic crisis in Korea and – realizing it had underestimated the market risk and been overconfident about the contribution its core competencies could make – it sold its car business to Renault in 2000.

6 Allow for unknown risks

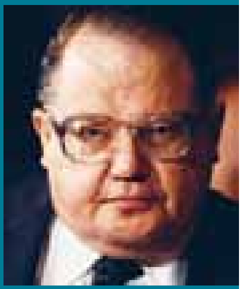
No matter how good your processes, you have to allow for the unexpected. For a financial firm, that means keeping capital in reserve; for others, it may mean ensuring management have the resource to handle problems that emerge out of left field.

The bursting of the South Sea Bubble in 1720, which ruined many British investors, is a reminder of how massive hidden risks can be. The South Sea

> *"If being risk-averse deters companies from growth, that's as serious as underestimating risk"*

Risk managers might have quashed Gone With The Wind

Moviestore Collection; Wally McNamee/Corbis



All that glitters...

Nelson Bunker Hunt (above) is a former Texan billionaire. He might still be a billionaire had he not decided, with his brother William, to try to buy the world's silver as a hedge against inflation and what he believed was a forthcoming economic apocalypse in which paper money would become worthless.

By 1979, a pool of investors led by Hunt had amassed what was variously estimated as between a third and two-thirds of the world's silver. But Hunt and his partners had ignored one large risk: the attitude that the authorities might take to their quest.

The risk of state intervention was known but hard to calculate until the early 1980s, when the alarmed U.S. authorities increased margin requirements for silver investors and reduced the amount of silver contracts any party could hold. Silver prices fell by 80%. To Hunt, these were "artificial factors", but they led to his bankruptcy and a lifelong ban from commodity trading.

Still, Hunt did give the world two great soundbites: "People who know how much they're worth aren't usually worth that much" and "Invest in silver and you can never go wrong".

Company, a British joint stock company, was granted a monopoly to trade in Spain's South American colonies during the War of the Spanish Succession (1701-1714). In return, it assumed England's war debt. Through promotion, insider dealing and a get-rich-quick fever, its shares rose tenfold in a year before crashing. Scientist Isaac Newton, one of thousands who lost money, noted: "I can calculate the movements of the stars, but not the madness of men." A dictum that ought to be on every risk manager's desktop.

7 Never underestimate the velocity of risk

Remember, risks alter. "If you see risk registers that change minimally from one year to another, it is not reflecting the real situation," says Engels. The dangers threatening a company change constantly and managers should regularly re-assess their strategy, measurement and appetite for risk – yet the KPMG survey suggests most do not have a clearly defined, updated register.

Boards are becoming depressingly familiar with the concept of 'velocity of risk'. Nolan says the existing audit committee or a newly created, board-level risk committee can help cope with the way risk rapidly evolves. Ideally, the internal audit function should have a voice on the board.

8 Communicate the strategy

There's no point having a risk management plan if the rest of the organization knows nothing about it. "Communications failures played a role in the most recent crisis," says Stulz. If a risk manager cannot explain a system to senior executives properly, even perfect systems can do more harm than good by inspiring false confidence, he says. "Worse, information can arrive to top management too late or distorted by intermediaries."

Too much information can swamp management, but it is important communication is horizontal – across the corporation – and vertical. In the KPMG survey, only 36% of respondents think their organizations ensure information about risk reaches the right people. "A failure in communicating risk to management is a risk management failure as well," says Stulz.

So how can a risk management culture be fostered? The International Financial Risk Institute says it's the board's responsibility to clearly allocate risk management responsibilities at the highest level to ensure accountability, placing risk control on a par with other strategic business matters. The function should be properly resourced, says IFRI, and risk control personnel recognized – not regarded as second-class citizens because they are not direct revenue-earners. It is vital that lines of communication are clear – so risks are reported to where they can be managed – and useful if project managers discuss risks with the relevant experts to secure buy-in. The board must ensure appropriate risk education continues throughout the company.

9 Invest wisely

The main obstacles to successful risk management used to be poor data quality and availability, shortage of relevant expertise and ineffective tools and technology. But many executives surveyed by KPMG identified a lack of financial resources as their biggest problem in the coming year. Without careful planning, a dearth of money will prevent problems being addressed.

10 Risk management isn't all negative

Risk strategies need not be a costly brake on entrepreneurial activity. Recession is making many users realize that ERM can be quantitative as well as qualitative and deliver a return on investment. By using ERM and creating a corporate risk awareness culture, companies can more shrewdly identify, monitor and prioritize risk, reduce the volatility of their results and save on wasteful insurance, hedging or excess capital.

If improved measurement shows companies operating below risk tolerance, they can increase exposure. Optimizing capital can cut financing costs and give scope to expand. Measuring lost opportunities is hard, but the effects are real and can justify the costs to even the most skeptical accountants. ●

Richard Northedge is a former U.K. Sunday Telegraph *City editor who appears as a commentator on Sky and Bloomberg*

Go further

Stulz's analysis of LTCM is Fisher College of Business Working Paper No. 2008-03-017. His article, 'Six Ways Companies Mismanage Risk', was published in *Harvard Business Review*, February 2009. The KPMG report, *Managing risk in perilous times: Practical steps to accelerate recovery*, is at *www.kpmg.com/Global/IssuesAndInsights/ArticlesAndPublications/Pages/Managing-risk-in-perilous-times.aspx*. For more on the history of risk, read Peter Bernstein's *Against the Gods: The Remarkable Story of Risk* (Wiley). The ISO's risk management guidelines are at *www.iso.org*

"If I wrote my memoirs, the title would be: It's Not About The CEO"

Jouko Karvinen, CEO of forest products giant Stora Enso, says managing change is all about acting fast, finding differentiation and focusing on teams, not stars

WORDS BY PAUL SIMPSON PHOTOGRAPHY BY DAVID SHORT

"Every morning I wake up and think 'where am I late today?'" For Jouko Karvinen, chief executive officer of the forest products group Stora Enso, success in business is, in part, a matter of speed and timing. "We sold our factories in North America just six months after I took over. That was 20% of our company and some people said we were going too quick, too early, but boy am I happy we sold them."

Relaxed, dapper, quietly forceful, 52-year-old Karvinen admits that life as Stora's CEO is never dull. He recalls, with a small smile, that his appointment in January 2007 was greeted in his home country, Finland, by such headlines as "Jouko who?" The anxiety was understandable. One in ten Finns is, in some way, dependent on Stora Enso, and Karvinen, though he had run divisions of ABB and Philips, was no household name. He learned the importance of speed early on his watch: "We have faced the threat – and then the imposition – of a Russian tax on wood exports, the weakness of the dollar, the oil price surge and then the credit crunch."

On top of this, Karvinen came into the pulp and paper producer with a clear mission: to manage change. "Even in good years, the forest products industry was struggling to repay the cost of its capital," he says. It didn't help that some investors believed that forest products was a sunset industry that was bad for the environment.

"People say to me, 'Aren't newspapers going online?' and I say, 'Yes, but packaging is moving from plastic to wood fibre'," he argues. "People often say, 'Don't you kill trees?' and I say, 'We plant two for every one we chop down and, by the way, that newspaper you're reading – that's printed on paper recycled from the one you read two weeks ago'. Finland and Sweden probably get four times as much of their energy from bioenergy as the rest of western Europe – and 70% of that comes from our pulp mills."

Credit, change and the zero option

The credit crunch has posed a challenge to forest products which, Karvinen says, "nobody can solve alone". In essence, he says, "we need to start with the premise 'this is what the customer is willing to pay for paper, so how do we find a way to make and deliver it at a low enough cost so we can all make a living?' It's better than wondering 'how do you split a zero?'"

Changing the industry is one thing, but Karvinen has a more urgent mission: to change

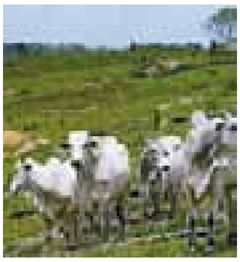
Key lessons

1. Thinking you're the best is a kiss of death. Think: what opportunities am I missing? And act.
2. Prioritize businesses with a clear point of differentiation: either a new product or a hefty cost advantage. Always ask: what is my winning advantage?
3. Never grow out of trouble: get your margins right first.
4. Choose your battlefield: beat competitors on your terms, not theirs.
5. You can't manage by always looking in the rear view mirror.
6. The true test of a CEO is whether their successor emerges from within.

Karvinen's road to the top

1982 Joins Finnish group Stromberg
1990 Vice-president, Power Electronics, ABB Drives
2000 Head of ABB's Automation Technology Products Division
2002 CEO, Philips Medical Systems
2007 Headhunted to join Stora Enso as CEO

Sustainability, whether in Brazil (bottom) or a Finnish factory, is high on Stora Enso's agenda



Stora Enso. As he sought to stimulate change, he looked back to his experience as CEO of Philips Medical Systems. The division had grown through four massive acquisitions and it was his job, effectively, to knit them together and make the business more profitable.

"General Electric were far bigger than us in healthcare, but it was our job to beat them. Everyone said we couldn't, they were too big. So we looked for ways to win. We could not do that by being bigger but by trying to be faster and, because we were Philips, by using our experience in the consumer markets and looking at healthcare from the point of view of the real customer, the patient. We set out to double our profit in 18 months – nobody thought we could do it, but we did."

Karvinen has started a similar process at Stora Enso. Concluding that 'size matters' was a cliché, not a strategy, he focused on profitability, aiming for a 13% return on capital employed (ROCE). The industry average is around 5%.

The credit crunch has made his target seem Utopian now but in 2007, the ROCE on the group's continuing businesses was up to 11.3%. And the focus on cash flow and protecting prices in recession has led Stora Enso to cut planned capex by 55% over 2008 and 2009. Having managed at a senior level in different countries, sectors and companies, Karvinen has been exposed to many management philosophies. But the crucible that forged him as a manager was the Swedish-Swiss engineering group ABB, where he worked from 1988 to 2002.

Karvinen almost fell into management. "My brother said university was fun – though I'm not sure how much of that fun had to do with studying – so I did a degree in power electronics, applied electronics and industrial economics." A job at Finnish electromechanical products group Stromberg soon followed. Speaking German pretty fluently, he was hopeful of the right posting but was sent instead to California to run a project. "My English was so bad I could barely order breakfast at the hotel," he says now. But he came through. And in 1987, Stromberg was bought by ASEA which, a year later, merged into ABB.

Brilliance, mediocrity and the CEO

Karvinen was lucky enough to be working for ABB when it was run by Percy Barnevik, a charismatic CEO once described as Europe's answer to Jack Welch. As Karvinen recalls those days, the lessons almost come tumbling out of him. “If you have a problem at work, many people manage it by telling their boss. At ABB, the question was always: ‘What would you do if you couldn’t ask me?’” But no manager was an island. They were encouraged both to be independent, and to recognize when help was vital: “Make sure bad news comes in one piece and early, not late and bit by bit.” The ABB mantra was to let managers make mistakes when they were young so the errors would cost less – but to make sure they didn’t keep making the same mistakes.

Karvinen learned a lot about the bottom line too (“at ABB, they always said, never grow out of trouble, too many people get killed that way – get your margins right first and then grow”) but many of the lessons that flew at him so thick and fast were about how to manage people. Having someone in the organization who knew which staff were ready for a challenge or a new project was crucial. Recognizing “it is easy to get stuck in a big company”, Karvinen encourages senior managers at Stora Enso to create a path that allows staff who are good enough to reach the top to fulfil their potential.

“One thing I learned is that, as a general manager, no matter how good you are or how hard you work, the biggest difference you can make to your team’s effectiveness is having the courage to hire people who are better than you are.”

The thought prompts him to give his own forthright variation on the “there are two kinds of people” speech: “There are two kinds of people in companies – the right people in the right jobs, and the right people in the wrong jobs. And if they’re in the wrong jobs, it’s the CEO’s fault. Often, when you move someone into a position and they struggle, people say they need time to settle in. But if you leave someone to settle into the wrong job, the organization will destroy them.

“Western business culture overvalues general management. We need to develop a dual career path, so specialists can do what they’re good at. If we don’t, we risk taking brilliant experts and making them into mediocre managers.”

By 2000, Karvinen was running ABB’s automation technology products division. Two years later, he was hired to run Philips’ medical systems division. Watching Philips CEO Gerard Kleisterlee transform the entire group, including selling off the semiconductor unit, he learned that sometimes as CEO you have to do what you know is right, even if the outside world does not immediately understand it.

Karvinen brings this singularity of vision to Stora Enso. Such modern business shibboleths as the urgency of doing business in China don’t impress him much. He flies to China four times a year to “learn, not teach”. The country accounts for 3% of Stora Enso’s paper and board production, but he says: “China is a large, growing market. It will be a large, growing market whether you’re there or not. The question we all have to answer about the Chinese market is ‘why would we win there?’”

Wins, costs and Lance Armstrong

“Can you win?” is a recurring theme in the conversation, which raises the question: what would he consider a victory? “I don’t care how big we are, I care about whether we can generate returns above the cost of capital. And you can do that if your investments give you a dramatic differentiation through cost advantage – not 2% but 20%, with something that can’t be copied at all, or not for many years – or if your product has a unique feature. For example, we have a new paperboard DVD case that has a tenth of the carbon footprint of normal cases.”

Asked to name managers or business thinkers who have inspired him, Karvinen reels off a list of colleagues. The management books and CEO memoirs he has read left him cold. “I’m not a great believer in the hero CEO. *Good To Great* was interesting, but that had a lot of data to back it up.”

Has he ever considered writing a book? He laughs and says: “If I ever wrote my memoirs – I’m not going to, but sometimes I say I will because my wife gets worried about what I’ll do when I finally retire – the title would be inspired by Lance Armstrong’s book, *It’s Not About The Bike*. I’d call my book *It’s Not About The CEO*.”

“Look for a real point of differentiation: it might be a product that can’t be replicated quickly or an area where your cost advantage is 20%”

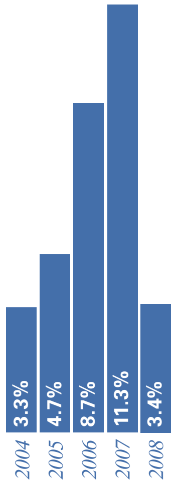
CEOs work in two time-frames: the fast-moving here and now and the enigmatic long term. If he signs off on a new paper mill, the investment could take 10, 20, or even 30 years to make an impact. So the quality of his successors is key. “As a manager, you need to know the numbers. I’m never impressed if I ask and someone has to look them up. But too many managers are led purely by budgets and forecasts. Business is inherently unstable and you need managers who can cope with that. One of the best ways to judge a CEO is on the quality of their successors.”

Karvinen was a dark horse candidate to run Stora Enso. He was succeeded at Philips by an internal candidate, Steve Rusckowski. When he arrived at Stora, Karvinen said he’d do everything he could to ensure that his successor came from within. That, you sense, would be his greatest victory. ●

Capital allowance

Stora’s return on capital employed

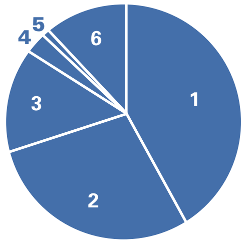
Source: Stora Enso



Global business

Paper and board capacity by country, 2009

Source: RISI



1 *Finland 42%*
2 *Sweden 28%*
3 *Germany 14%*
4 *China 3%*
5 *Brazil 1%*
6 *Others 12%*

Stora Enso at a glance

- Founded in 1998 after Swedish group Stora merged with Finnish rival Enso
- The group has 29,000 staff and 85 production facilities in 35 countries
- In 2008, sales stood at US$17.3bn (€11.03bn)
- Stora has cut capex but is still acquiring, and spent US$434m (€276m) to build a pulp mill in Uruguay

HEALTHCARE: HOW BAD IS IT, DOC?

The prognosis seems bleak as healthcare inflation grows – and that's as critical for business as for patients and governments. Three specialists diagnose the problems

BY RHYMER RIGBY

When Howard Schultz, CEO of Starbucks, says his company spends more on healthcare insurance than on coffee, it's terrifyingly clear how critical the financial impact of healthcare has become.

America's Congressional Budget Office predicts that unless federal law changes, the U.S. will be spending 25% of its GDP on healthcare by 2025. So it is easy to see why Barack Obama has decided to overhaul the U.S. healthcare system. Change is inevitable – but, as the debate over Obama's plans shows, agreeing on that change seems impossible. Many other countries will, at different times in the future, face their own reckoning on healthcare. This January, China announced a US$124bn (€87bn) healthcare reform plan which predicts that by 2011 the state will bear the brunt of the nation's healthcare costs.

As analysts and commentators have begun examining the controversies – and success stories – surrounding current global healthcare provision, private sector involvement has been given a predictably mixed review. Research-driven innovation and technological breakthroughs will extend life span but increase the associated costs of caring for older people, according to a report by the influential RAND Corporation. And a lack of genuine competition among insurers has been blamed for adding to the problem in the U.S. (see chart, page 18).

Yet a thriving private healthcare sector in India has slashed costs and increased provision, and there are signs in Europe – including in the UK's state-run National Health Service, Europe's largest employer – and parts of Asia that public-private partnerships are starting to deliver real change, and sustainable revenue for the businesses involved. For companies willing to engage with the issues, there is a genuine opportunity to enter new, rapidly expanding markets.

Agenda spoke to three experts with different perspectives: Shivinder Singh, managing director of India's Fortis Healthcare hospital chain; Dana Goldman, chairman and director of health economics, finance and organization at the RAND Corporation and a professor at UCLA; and Alan Downey, KPMG's Global Head of Healthcare and a partner in the UK firm.

How big is the burden to business of rising healthcare costs?

Goldman There are concerns about healthcare costs affecting competitiveness, although in some cases these are overblown. We know, for example, that much of the cost ends up falling back on workers in the form of lower wages. However, for some companies with legacy commitments to retirees, including GM, healthcare promises made decades previously are impacting on the bottom line. Over the past few decades, industries with more health coverage in the U.S. have experienced less job growth. That is worrying.

Downey In any country where the cost of healthcare is borne by business, it is a huge issue.

> *"The biggest problem is that you can't shop around. Hospitals don't post their prices, and with third parties paying the bill, why would they?"*

The panel

ALAN DOWNEY
KPMG's Global Head of Healthcare and a partner in the UK firm; a former civil servant

DANA GOLDMAN
Chairman and director of health economics, finance and organization at think tank the RAND Corporation, and a UCLA professor

SHIVINDER SINGH
Managing director of India's Fortis Healthcare hospital chain and co-owner of brokerage firm Religare Enterprises; a regular on Forbes' 'India's 40 Richest' list

Dirk Anschutz/Getty Images

THE COST OF ILLNESS

The World Health Organization says China will forego US$558bn (€395bn) in national income during the decade to 2015 due to chronic diseases. Globally, deaths from chronic disease are expected to rise by 17% in the same period.

BROKEN CHINA

China now spends US$161m (€116m) on healthcare, 75 times what it did in 1978. But the state plans to spend more as it seeks to extend medical insurance to 90% of the population.

COST VARIATIONS

The U.S. health system costs 83% more per capita than Canada's, which is 70% funded by taxes. Americans pay roughly US$500 (€350) a month for full coverage; Taiwanese pay US$20 (€14).

INSURING THE FUTURE

On average, only 28% of the population of the 30 OECD nations has private health insurance. These countries spend an average of 9% of GDP on healthcare, but the U.S. – by far the biggest spender – pays 15.3%, a figure that is forecast to hit 20% by 2017.

Stuart Forster/Alamy

Getting better all the time

How technology can meet healthcare's most pressing challenges

1 Sharing information
The U.S. has pledged US$19bn (€13.5bn) to create a national IT infrastructure for healthcare providers. Swine flu in the Middle East is being tracked by an IBM-designed system which helps experts analyze the spread of diseases in real time.

2 Streamlining diagnosis
When you're in a remote part of a developing nation, how do you diagnose complex conditions? Non-profit Click Health arms health workers with camera phones to send pictures to consultants on the other side of the world.

3 Monitoring patients
Remote technology means doctors can keep an eye on at-risk groups (such as diabetics or the elderly) through devices linked to phone lines. Patients take their insulin levels or blood pressure, and doctors are alerted to potential problems.

4 Speeding up treatment
Aravind Eye Hospital in India performs 50,000 operations per year and offers cataract surgery for US$50 (€36) by keeping operating theatres in use 24 hours a day, and allowing surgeons to monitor two operations at once. At Narayana Hrudayalaya hospital in Bangalore (above), heart bypass surgery costs as little as US$2,000 (€1,433).

That's why people say GM is the biggest healthcare insurer in the world [the company spent US$4.6bn (€3.2bn) on healthcare in 2007, equivalent to US$1,525 (€1,065) for each vehicle it sold].

What obstacles prevent change?

Goldman There are enormous vested interests in the status quo. The political process hinders change. Take Medicare [in the U.S.]: it's a dinosaur. It can't reform – that's the problem with single-payer systems, no-one will take a really fresh look and pay for performance. There are too many vested interests.

Singh The biggest obstacle to fixing problems is for someone to have authority and be protected from the downside. It's too emotive a subject for people to tackle in a practical way. It's very hard to fix problems if any change you make causes riots in the streets.

Downey The governments that get it right understand the need for universal coverage regardless of ability to pay, but recognize that you can't fund what everyone wants from taxation, so they mix both. People say this produces a two-tier system, but I see no alternative.

What part can increased competition and private sector involvement play?

Downey One of the arguments about private sector partnerships is that governments can borrow more cheaply than the private sector, so why would they involve it? To me, that's missing the point. It's about having access to the expertise and enthusiasm which can drive down costs.

"It's very hard to fix the problems if any time you make a change it leads to riots in the streets"

Goldman The big problem in healthcare is that you can't shop around. Physicians and hospitals don't post their prices, and with third parties paying the bill why would they? And even if we knew the prices, the reality is that most patients don't even know the services they need until they see the doctor. To help stimulate the market, we can make pricing more transparent for basic services (say, for example, an office visit) and make sure regulations allow managed care organizations to exclude providers who are too expensive.

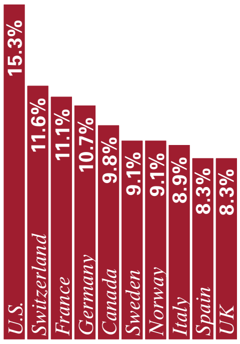
Singh In fields like IT, improvements in technology go hand-in-hand with falling prices; in healthcare, technology has improved, but prices have risen. There is huge scope for innovation and improvement.

Will facing awkward truths be part of changing the system?

Goldman Yes. The least expensive thing to do is to let someone die, although it's also the most expensive because life is so valuable. We don't do a good job of weighing up the costs and benefits. If we let the technocrats take over, we'd be OK.

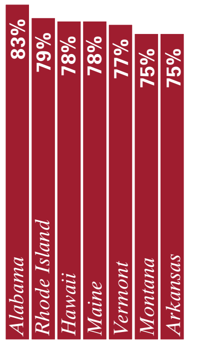
The cost of care

Healthcare spend as a percentage of GDP
Source: OECD



No contest

Market share of the largest insurer in selected U.S. states
Source: *Business Week*



Singh In fast-growing economies like India and China, employees in better positions tend to get the best healthcare. If GDP grows by 10% every year and healthcare inflation is 3-4% it's nothing to worry about. It's only a problem in developed countries with slower growth, where healthcare inflation outstrips economic growth. Almost all small, developed countries get it right – places like Singapore and the Netherlands seem to have it figured out. As the model is quite small-scale, the question it begs is: why can't we break up countries into small islands of 10m people or so?

Downey There's a consensus in healthcare that you get better outcomes and lower costs if you move care upstream – education, early diagnosis and managing conditions. Outcomes are better for patients, but it may push costs up. I wonder if we are pursuing goals such as ever-extended life expectancy without thinking it through.

How big is the opportunity for the private sector?

Goldman There will be many reforms in the healthcare system over the next decade, and change always presents opportunities. Businesses that understand where the healthcare system is headed will do best. I expect much more focus on deriving value, and this will affect the pharmaceutical industry, the hospital industry, and others. With healthcare at nearly 17% of GDP and going up in the U.S., reform will lead to big winners and losers.

Downey In the NHS, there has been a lot of controversy over independent treatment centres, which involve the private sector. But the NHS has gone away and innovated and come up with new services in the face of that threat, which actually proved the validity of the exercise. The private sector benefits from extra business, and the overall standard goes up too. ●

left field

From good to great

Keen to make your teams more productive? The strange collaboration behind T.S Eliot's *The Waste Land* dispels many of the myths that handicap teamwork

BY PAUL SIMPSON

Poets are reputed to be solitary geniuses who wander lonely as a cloud as they pen verse. But the 20th century's greatest poem, *The Waste Land*, was the fruit of intensive teamwork by T.S. Eliot and his friend, the poet and critic Ezra Pound.

Eliot and Pound were unlikely collaborators. Eliot was formal, almost congenitally shy, with hidden, but deep, eccentricities. (When separated from his first wife, for example, he greeted guests while wearing green face powder, and insisted on being referred to only as 'Captain'). Pound was brilliant, intellectual, bombastic, supremely self-confident and, in later life, a Fascist.

J. Richard Hackman, professor of social and organizational psychology at Harvard University and author of *Leading Teams*, has identified five basic principles that define a good team. And odd as Eliot and Pound's collaboration over *The Waste Land* was, it met three of these conditions.

The first principle is that teams must be real. "People have to know who is on the team and who is not," says Hackman. Sounds obvious, but his research into teams of senior executives found that fewer than 10% agreed who was on the team. Dr Edward Hoffman, an expert on teamwork and director of NASA's Academy of Program and Product Leadership, says organizations should "create the smallest team possible that includes all the necessary skills". There was no confusion on *The Waste Land*: Pound and Eliot were the team. Usually communicating by post, rather than in person, they were a virtual team 50 years before the internet existed.

The second principle is that teams need "to know and agree on what they're supposed to be doing together". Eliot, as poet, decided the goal – to improve *The Waste Land* – but it was Pound who, with his cajoling, praise and brutal criticism ("Bad but can't attack until I get the typescript", he noted in the margin once), defined how that goal was accomplished. Their roles were clear but, as Hoffman recommends, fluid enough to evolve – Pound felt free to suggest wholesale cuts which Eliot, on occasion, happily ignored.

Every good team needs a structure that enables it to do its work. Pound and Eliot's task was clear, if daunting. They had what Hoffman calls a "rich, intimate and emotional relationship", and their mutual trust encouraged them to be open. This is where many teams go wrong. In one team Hackman studied, he noted: "Being a team player was so strongly valued that individuals self-censored their contributions for fear of disrupting team harmony." Emboldened by Eliot's trust, Pound felt no compunction about damning his friend's fondness for modifying adjectives like 'perhaps', advising on the poem's structure and playing the vital role of the team deviant who isn't afraid to ask the awkward questions.

Eliot and Pound had discussed poetry for eight years before they started serious work on *The Waste Land* manuscript. That probably eased their task. Hackman says the idea that new teams are more productive than established ones whose members have become familiar with each other is a fallacy. NASA research has shown that tired crews who had worked together previously made 50% fewer errors than crews of rested pilots who had never flown together.

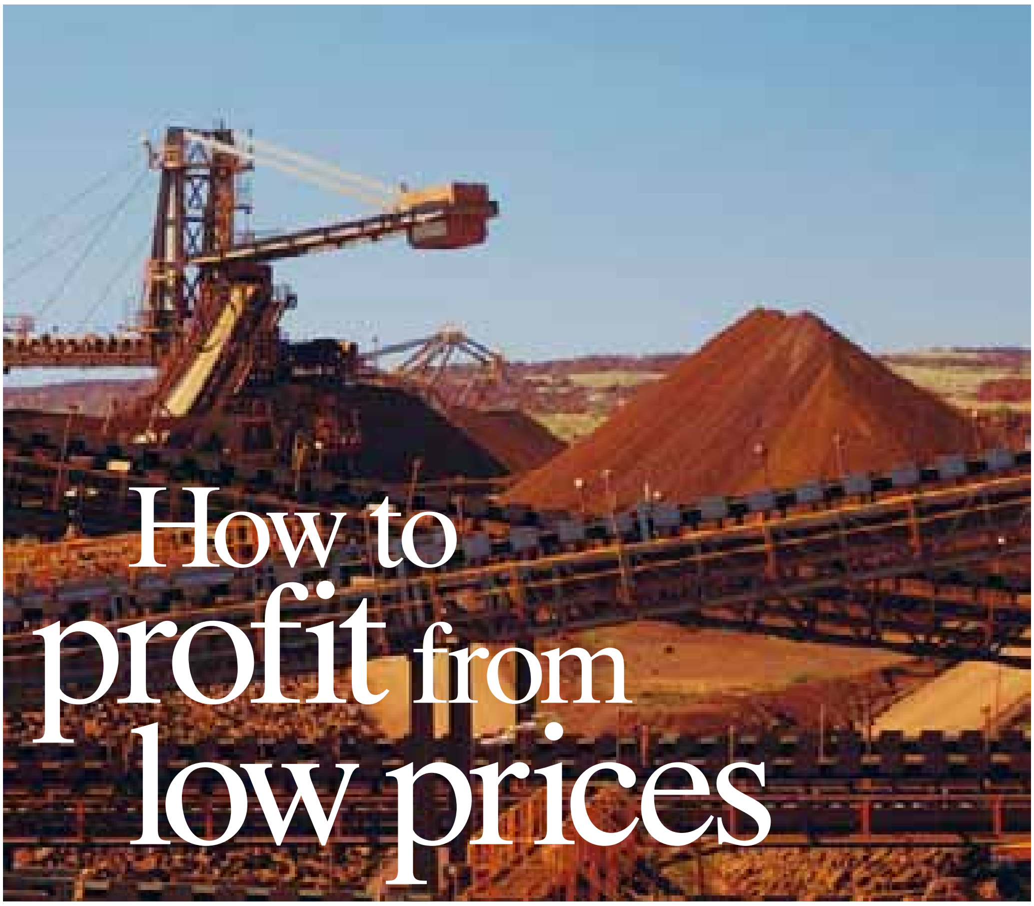
There were, mysteriously, none of the explosive ego clashes which wrecked the Surrealist movement. Pound recognized that *The Waste Land* was "enough to make the rest of us poets shut up shop", but Eliot realized Pound was the most useful critic he could have had. Together, they took the drafts of *The Waste Land* and made one of the most difficult jumps in business: from a good 19-page poem to a great 434-line one.

As an awkward, perceptive critic, Ezra Pound (above) worked closely with T.S. Eliot to create a modern masterpiece

Tropical Press Agency/Getty Images

Go further

Read Hoffman's principles of effective teamwork at *tinyurl.com/agendalf1*. Hackman's research on teamwork is at *www.people.fas.harvard.edu/~hackman*. Read the poem at *www.bartleby.com/201/1*. Or buy the facsimile and transcript edition (Harvest Books).



How to profit from low prices

Mining giant Vedanta can't control its prices, so managers and staff collaborate to revolutionize costs and boost performance

BY PAUL SIMPSON

Do you know how many companies in the 1960 Fortune 500 were in the same list in 2008? The answer is 76. That corporate mortality rate should focus the mind of every CEO and CFO. Navin Agarwal, deputy executive chairman of diversified mining group Vedanta Resources (pictured right), says this trend has driven the company's relentless desire to sharpen its competitive edge through an internal process that improves performance, whatever happens in the marketplace.

"If you look at the Fortune 500 companies between 1960 and 2008," he adds, "you find that many were unable to sustain their position under pressure from new 'attackers' in their industry. The drop-out rate among these companies has intensified, which suggests that the challenge of sustaining business is becoming tougher." Indeed, almost 40% of leading U.S. industrial companies dropped out of the first quartile of their sector during the 2001 recession.

And sustaining the business is harder still – because of the sector it is in. "We are in the commodities business," says Agarwal, "which means we have no control over the top-line price for our goods and services. Everybody gets the same price for the product, so the most successful companies have the lowest cost of production."

When Agarwal says "no control", he's not exaggerating. From the middle of 2008 to the middle of 2009, the price of aluminium plummeted by 52%, copper slumped 45%, while zinc prices fell 19%. The only way to survive such drastic fluctuations – let alone give yourself a clear competitive edge – is to perfect a model that continually improves performance so you have the lowest cost of production (COP). That is just what Vedanta Resources has done.

The company's roots go back to 1976 and in 2003 it became the first Indian company to be listed on the London Stock Exchange, as Vedanta Resources. In 1996, management started exploring programs such as Total Quality Management, realizing that the group, if it was to go beyond its Indian base and become a truly global player, had to transform its efficiency.

What has emerged is a structured program to encourage entrepreneurialism that delivers something greater than the one-off benefit to be had by high-profile belt-tightening. Agarwal

Bad fortune

Most of 1960's Fortune 500 companies have now left the list. The figures below show the survivors from the 1960 group at various points.

1960
500

1985
247

2008
76

Peter Hendrie/Getty Images

believes a company's cost advantage has to be systematic and sustainable. To achieve that, Vedanta studied programs such as Six Sigma and the Toyota Production System, that have delivered sustained improvements in performance.

From this research, Agarwal concluded that the most successful programs have three core elements: "A technical operating system, the mindsets and capabilities of staff – and the right management infrastructure."

To make this process work, Agarwal says, you have to ask six questions: "What tools do you use to generate improvement initiatives? How do you involve internal and external experts? How do people think, feel and conduct themselves in the workplace? How do you build their capabilities so they can drive the improvement program? How do you organize systems and processes to encourage the generation and implementation of new ideas? And what reward and recognition systems do you put in place?

"If you haven't got the right mindset, you'll have a nice theory but no execution. If your operations practice isn't right, you'll have highly motivated staff whose ideas make no impact. And if the management infrastructure isn't there, you won't be able to steer the process," he says.

So how is this theory put into practice? "If it was done as an order from head office, it would never work," says Agarwal. "It has to be embedded in the culture. We have 8,000 professionals – every one of whom has, at least, a first-class science degree – in our workforce of 30,000. We recruit the best, brightest talent, encourage them to grow and provide clear paths for them to take up leadership roles."

These professionals, and other senior staff, are appraised not just on their day-to-day job but on the commitment, imagination and collaborative effort they bring to sharpen business performance. They usually work in small, grassroots teams who take on a specific project with an agreed timeline. "The process lets the people who have identified the opportunities run these teams," says Agarwal. The reward mechanism is based on long-term incentives, partly driven by the share price performance. In the company's experience, conspicuous examples of success breed other successes, because all staff can see that the process delivers. Performance improvement, Agarwal says, is "a journey, not a destination".

All staff understand that – even those at businesses acquired by Vedanta. The improvement process yields a variety of initiatives, from small changes in working practice to large capital investments, but does it deliver the goods? Agarwal is convinced it does: "If you look at the cost of new projects in the mining industry, we are delivering these projects at 25-30% lower cost than the industry average and completing them in 25-30% less time than the industry average. These breakthroughs cannot be achieved unless we focus on health, safety and environment, which are at the heart of our sustainability strategy."

"Our projects cost 30% under the industry average, and we complete them in 30% less time"

Vedanta believes it is among the lowest-cost producers of copper and zinc in the world. The group's 2009 results (year to March 31) show that, despite a US$1.4bn (€1bn) drop in earnings as metal prices plunged, its working capital improved by $621m (€446m).

The picture is clearer when you study Vedanta's business units. In six years, Indian copper-maker SIIL doubled production and reduced the cost of production by 80% (see graph, right), after teams eliminated several bottlenecks, raised productivity, managed by-products more effectively and used less liquefied petroleum gas in the smelter.

At iron ore subsidiary Sesa, teams sweated the detail on small initiatives and combined them with major changes, such as buying railway sidings to transform logistics costs.

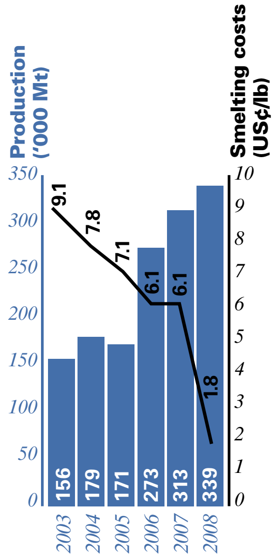
At zinc maker Hindustan Zinc (HZL), bought in 2002, a switch to a more performance-linked compensation scheme, a Six Sigma program and the commissioning of a new power plant (completed in seven months) helped raise output by 18% and cut cost of production by 22% in the first year of acquisition (see graph, right).

These are not small numbers. And they have helped fuel Vedanta's growth, as it seeks to become one of the four largest players in aluminium, the biggest zinc company (it is currently second behind Xstrata), one of the top two copper-makers and one of the ten leading iron ore suppliers.

Many of the company's rivals have delayed or shelved plans to bring new mines or capacity on stream. Others are seeking to drive a consolidation process through acquisition. Vedanta regards the downturn as an opportunity. The group isn't yet in the Fortune 500, but this US$6.6bn (€4.7bn) revenue company will, if Agarwal is right, be around far longer than many of those that already are. ■

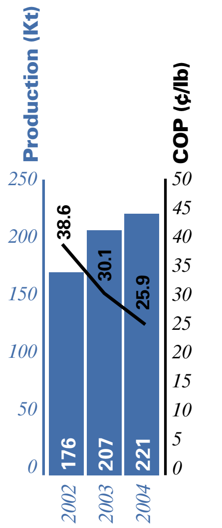
SIIL: bigger means better

Vedanta's SIIL cut its smelting costs by 80% in 2003-08



Hindustan Zinc: thinking smart

HZL's efficiency drive: in two years, COP is down as output climbs



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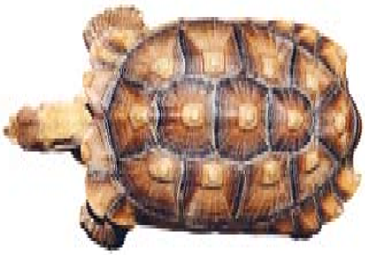
10 issues on the horizon

In turbulent times, being prepared is essential if you aim to thrive rather than merely survive. Here are ten challenges that could define your future



1 Achieving closure

"If it were done, when 'tis done, then 'twere well it were done quickly." Many firms that close units have followed Macbeth's advice. However, the desire not to prolong the agony – and make quick cost savings – can destroy morale and damage shareholder value.

Less Macbeth, more tortoise might be better. Treat a closure as a major project. Use an experienced leader with a strong team. Ensure people receive compassion, decent notice and good communication: it may help you avoid alienating staff, customers and suppliers – and damage to your reputation.

Thomas Morris, president of consultants Morris Associates, says a downsizing plan should be "constructed from head and heart". The Swedish Postal Service, which halved its workforce of 72,000, gave staff 18 months' salary if they joined a job-seeking program: 3,000 did and 85% found work. This proved nicer – and cheaper – than the usual early retirements and severance packages.

The quick and dirty approach to closure may seem cost-effective. But when stories about your staff having to clear their desks reach the market, the only winners are your rivals.

2 Divestment

M&A grabs headlines, but selling a subsidiary can be as transformational – and testing. Pressure to sell underperforming or non-core businesses to raise cash is mounting. KPMG's M&A Spotlight survey of managers found that a third expect to make one or two divestments this year (see chart below).

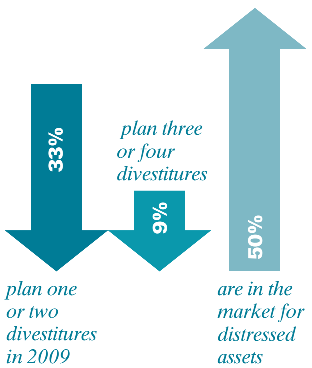
Such sales can bolster balance sheets and redefine vision. Dutch financial services group ING plans to sell 10-15 businesses for up to US$11.18bn (€8bn), to create what CEO Jan Hommen calls a "more focused group, with growth potential".

Deciding how to deal with shared overheads, brands, patents and processes can be tricky. Smart divestors sweat the detail. Conglomerate Textron's team of divestiture experts keeps a database of would-be buyers and, from 2001 to 2008, it has produced shareholder returns 6% above those of its peers.

Divestment is not a tactic, but a strategy. It has been claimed media group VNU might not have been acquired by private equity groups in 2006 had it divested better.

The divestment paradox

KPMG's April 2009 survey of 270 M&A professionals found:



3 Ethical investment

The Quakers started it. Long ago, they decided their modest pension funds would not support the arms trade. Once derided by many stockbrokers, ethical investment funds have delivered reasonable, sustainable returns. The twin crises of climate change and the credit crunch mean that socially responsible investment (SRI) has gone beyond saving souls to saving the planet – and shaping corporate agendas.

The remit of SRI has broadened far beyond carbon emissions and sweatshops. The Australian Ethical Investment fund shuns firms who "create markets by the promotion of unwanted products", "acquire land or commodities for speculative gain" and "entice people into financial over-commitment". If such criteria became universal, how would your business fare?

Ethical investors could sway hard-nosed investors, especially if they use the techniques of shareholder advocacy to make a fuss over remuneration, bonuses and perks. In 2003, Pfizer started talks with religious investors worried about pay disparities. As one corporate PR guru puts it: "CEOs don't like to be shouted at by nuns at AGMs."

Portrait Essentials/Alamy; Shutterstock

4

Why green is good for your bottom line

Investing now may be better and cheaper than retrofitting later

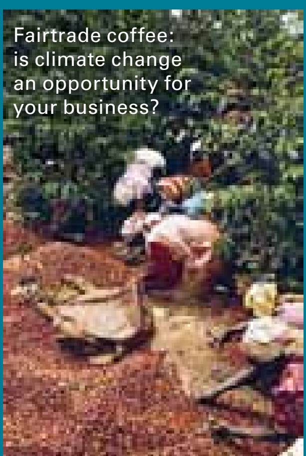
For companies weathering the storm of the financial crisis, valuing the risk of climate change may not seem like a worthwhile investment. However, forward-looking companies that start investing in 'green' initiatives may find that opportunities abound.

As the public begins to evaluate companies with a green eye, brand analyst Landor predicts that firms positioned as green leaders are part of a "long-term megatrend" that will carry into the next decade.

Management consultant A.T. Kearney analysis found that companies committing to sustainability during the current crisis are outperforming their peers in the financial markets. A World Resources Institute policy brief for the U.S. Congress, *A Green Global Recovery?*, argues that demand for green technologies will give first-mover companies a competitive edge, cost savings and greater efficiency.

As for the science, there really is no question about the business risks of climate change. Rising temperatures affect agricultural output, new diseases reduce employee productivity, severe weather disrupts logistics, while resource constraints increase energy and water costs.

Likewise, the global response to climate change—including climate legislation—will transform the way that many economic sectors do business. Companies may be forced to adapt their products or technologies to new regulations and must decide if it's better to invest now rather than retrofit later. Litigation against polluters may increase as plaintiffs more easily link companies' emissions to environmental damage. Internet communication tools have made it easier to attack the reputations of companies that are associated with 'dirty' projects. Many businesses are likely to find they simply cannot afford to leave going green until tomorrow.



Fairtrade coffee: is climate change an opportunity for your business?

By Kirk Herbertson and Shally Venugopal, associates at the World Resources Institute (www.wri.org).

5

Lean finance

Could your finance department do more for less? With KPMG's 'Being The Best: thriving not just surviving' survey showing that the best-performing finance functions have an average of 16% greater influence on core operations, likely gains are significant.

'Lean management' – removing processes that don't contribute to end value – could help. Lean Enterprise Institute founder Jim Womack says: "Traditional financial metrics need to be removed from day-to-day decisions on key processes. Toyota has a conventional accounting system, but operating managers don't use it to manage. Instead, they look for waste and remove it, knowing from decades of experience the financial numbers will be positive, although possibly with some lag."

Small steps such as simplifying, standardizing and automating invoicing, or faster reporting, can make a big difference. However, CFOs can be more ambitious, focusing on real needs of customers – rather than internal perception of those needs – to cut costs and simplify processes. Indeed, some CFOs say lean accounting is superior to the "post-mortem approach" of traditional accounting.

6

The valley of debt

Moviemaker Orson Welles lived like a millionaire even when he wasn't one, making sherry ads to pay creditors. Few businesses are as spendthrift, but many, like Welles, don't fully understand the nature of indebtedness.

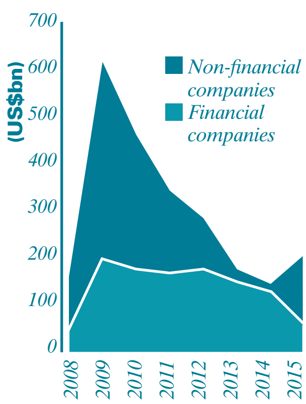
"Debt was ignored, because the terms of trade were so easy," says Neill Thomas, Partner and Head Debt Advisory, KPMG in the UK. Even now, once facilities are refinanced it is assumed debt is off the agenda and focus is lost. Thomas warns: "If you don't remain on top of your financing, it will come back to bite you."

For many borrowers, 2009 is Year Zero (see graph). Thomas says the next year is critical and advises companies to review facilities and covenants, subject financial projections to timely and sceptical analysis and identify actions to preserve cash. No short cuts: liquidity remains key.

Short-term pain

Maturity dates of outstanding European corporate debt

Source: Standard & Poor's Global Fixed Income Research



7

M&A the BRIC way

With savvy investors worrying that M&As never deliver value, Western CFOs could learn from the way multinationals in emerging economies acquire firms.

In June, Chinese refiner Sinopec bid US$7.2bn (€5.2bn) for Canadian oil explorer Addax Petroleum, the largest overseas acquisition by a Chinese company. In 2007, Indian aluminum producer Hindalco bought Canadian giant Novelis, twice its size.

The sector has been affected by the crunch, but intelligence service mergermarket.com reported that BRIC M&A deals in the first half of 2009 were still worth US$102.5bn (€72.4bn).

So what is the BRIC secret in tough times? Rather than doing deals reactively, these cash-rich firms identify targets that will drive development over the longer term. Deal-makers from emerging economies seek new technology, skills or intellectual property to complement their low-cost model. Kumar Birla, chairman of Indian conglomerate Aditya Birla Group, says it "acquires talent, not just assets".

With so many Western firms suffering, Chinese and Indian companies will have no shortage of targets.

8

Benchmarks

"If you want your company to become world class, it is likely that another organization will be achieving superior performance and you should learn from them," says Joe Goasdoué, CEO of the British Quality Foundation. "You should be looking at the best, regardless of industry."

The trouble with sector-specific metrics is that it's easy to relax if your figures are above the norm: but successful firms push harder. Computer giant Dell was best in class for managing working capital but Michael Dell realized, when he studied retailers, that his company could improve still further.

When Dr Robert Camp initiated Xerox's successful benchmarking program, he saw that "the unique and innovative practices we needed to remain competitive did not exist within our industry". Camp found that a wider remit made benchmarking an easier internal sell: "If we take one of our managers to a competing warehouse at Kodak, he becomes defensive, because Kodak is doing things differently. Take him to an automotive parts warehouse and he does not find it threatening."

The best way to persuade managers, already trained to believe they are the best, of the need to change is to let them see the evidence.

9

Managing IT risks

The civil servant who leaves the office laptop on a train is a figure of fun, but data loss is no joke. It harms security, damages reputation and exposes your information to public scrutiny – and it is getting worse. KPMG's Data Loss Barometer predicts serious incidents will rise 10% in 2009. Much of it is "easily preventable and silly", says Malcolm Marshall, Partner, KPMG in the UK.

He views memory sticks, CDs and portable media (such as iPhones) as high-risk items often used to take data home: "Personal responsibility is important. People wouldn't leave a wallet lying around, but will leave a CD on display."

The most recent corporate victim is a payment processing company, where up to 130m credit card details from customers of U.S retail chains are alleged to have been stolen by hackers in what could be the biggest ever data loss.

Marshall says managers must know where sensitive customer data is held. Better security and employee awareness programs can help. There are so many big risks in IT – data security, viruses, tech failure – managers should spend less time on self-inflicted wounds and more on preventive measures.

10

Your next job

Market turbulence is giving CFOs the chance to apply their skills – described by one finance chief as a "crystal-clear view and an obsession with control" – as CEOs. Buccaneering, deal-making CEOs are out, as cash is again king, belts are tightened and debt moves sharply into focus.

Royal Dutch Shell's appointment of CFO Peter Voser as CEO raised eyebrows, but it's part of a trend. One-fifth of Fortune 500 CEOs are former CFOs; Nokia president Olli-Pekka Kallasvuo and WPP Group CEO Sir Martin Sorrell both spent a decade in finance before taking the top job.

CFOs start their new role with one big advantage: like the CEOs they replace, they are used to seeing the business as a whole. The key is to successfully delegate the finance function (without easing up in the war on waste or the quest to find cash in the business), communicate often and, if necessary, adjust your style: the tone that suited finance may not fit as CEO. David Tyler, chairman of IT giant Logica and an ex-CFO, has a word of caution: "If you, as CEO, do a turnaround, you're a hero. If you fail, there may not be a way back to a finance role."

Christopher Pillitz, Biggie Productions, Image Source/Getty Images; Sipa Press/Rex Features; Shutterstock

The business of government

Recession has brought big government back – but for how long? And in an uncertain fiscal, political and regulatory climate, can firms protect shareholder value?

BY PAUL SIMPSON

Ronald Reagan declared in his 1981 inauguration address: "Government is not the solution to our problem, government *is* the problem." As a sign of the times, Josef Ackermann, CEO of Deutsche Bank, told a conference in Frankfurt last March: "I no longer believe in the market's self-healing power." In a recession, government – in an ironic twist that would have perplexed the former U.S. president – has emerged as the savior of capitalism.

The changes have been so quick and unprecedented, it's worth recapping how far we have come. Many banks in the U.S., Europe and Japan are partially or largely state-owned. The AIG bailout makes Washington a major player in insurance. Many governments have provided billions of dollars in loans and equity infusions to car makers and are intervening, as investors, guarantors and subsidizers, in energy, housing and telecoms. The G20 heads of state, who speak for 83% of the world's GDP, aim to lead an unprecedented global revolution in regulation to ensure that the interests of financial institutions and society never diverge as catastrophically again.

It is easy to see why political strategist Robert Reich, an adviser to Barack Obama and labor secretary under Bill Clinton, believes the "pendulum of public trust" has swung decisively away from business. In the July/August 2009 *Harvard Business Review*, Reich predicts CEOs will be under "tighter scrutiny than we have seen for decades", affected by "indirect forms of intervention" – albeit with regulations seeking to coax rather than control, relying less on rules and penalties than incentives to reward business behavior government believes is in the public good. He suggests "managers will work more directly with government than at any time since World War II" and "partner with it rather than fend it off". Boiled down to basics, Reich's argument is that big government is back.

But for how long? John Herhalt, global chair of KPMG's government sector and partner in the Canadian firm, says: "In an economic crisis, government does the things it believes are necessary to protect the public interest. Sometimes that can be quite extreme. But government has no intention, in the long term, of being an owner and stakeholder in the automotive industry, banking or insurance." The pendulum has not swung so far back that ministers subscribe to the neo-Keynesian orthodoxy that government should control or heavily regulate what Lenin famously described as the "commanding heights" of the economy. The goal is to save the free economy, not destroy it.

Benjamin Segal, assistant professor of accounting and control at INSEAD, says that from the investor's point of view, the old strategy of "regulation with a light touch" wasn't efficient. "If you take issues such as stock-option expensing, off-balance-sheet financing and capitalizing leases, for a long time it was impossible to get a true picture of a business. Investors could end up investing in companies riskier, more leveraged and less liquid than they thought."

Market capitalism is supposed to work because it allocates funds to companies that most deserve them. In practice, Segal says, the true differences between businesses competing for funds are obscured by an opaque, imperfect and inconsistent approach to regulation and accounting standards.

Tainted politics

"In theory, regulations will facilitate vibrant markets, but the process by which these regulations are drafted is politically tainted, so it is very tricky," he says. Improvements can take years, and industries may lobby hard against them, so new rules, intended to be for the common good, are often far from perfect. Businesses often insist that every change – such as accounting for stock options as a cost in a profit-and-loss account – would make them uncompetitive. To Segal, clear, fair and consistent regulation would be good for the investor – and CEOs: "If you look in a mirror and don't like what you see, it's not the mirror's fault."

A history of government intervention

1800s
Industrial capitalism
The ideas of David Hume and Adam Smith lead to the collapse of British mercantilism, with factory owners replacing merchant adventurers.

1920s
Socialist realism
With Russia's economy foundering, Lenin authorizes limited private enterprise through a New Economic Policy. In 1928, Stalin brings in a fully planned economy.

1933
New Deal
President Roosevelt uses 'state capitalist' economic policies to help the U.S. out of the Depression, including banking reform and work-relief schemes.

1944
Bretton Woods
A conference, inspired by John Maynard Keynes, creates the IMF and sets in place a global system of governmental exchange rates.

INTERNATIONAL MONETARY FUND

G20, 2009: Behind the smiles, heads of state face hard choices about debts and cuts

Herhalt is more optimistic about the benefits of new regulation and says that, outside the financial sector, CFOs should not fear a new round of controls as costly and onerous as the Sarbanes-Oxley Act (see panel, page 28). But he warns policy makers: "Government cannot introduce regulation that would eliminate risk. The question is: what is the acceptable, balanced risk to be left in the economy?" The other question, Segal says, is what might be the unintended consequences of these new regulations?

Reich is right to say that the dynamic of the relationship between government and business has changed. As he says, the imperative is for CEOs to "engage with, not shield from" government, helping to resolve government concerns, not block or ignore them. In the short term, some politicians – perhaps the European Union itself – may seek to micro-manage bonuses and remuneration. That will pass. But in an age of unprecedented media scrutiny, with the public trusting business as little as they do politicians, companies will have to consider the public good to protect shareholder value. The adage that what's good for business is good for the country no longer applies.

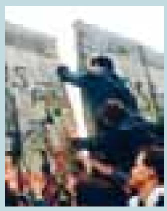
The multinational rescue mission to save the world economy suggests that big government has made a startling comeback. But the neo-Keynesian renaissance is far from permanent. As Segal points out, we no longer believe one economic theory has all the answers. The cycles of action and reaction, state intervention and privatization, have left governments taking astonishing steps: not in the name of a particular political or economic philosophy but as pragmatic responses to a crisis that exceeded all expectations.

1945-51
Commanding heights
The U.K.'s post-war Labour government makes the state the major actor in the economy, nationalizing coal, rail and steel and setting up the National Health Service.

1961
Chinese whisper
A crack in communist ideology appears when Deng Xiaoping says: "I don't care if it's a white cat or a black cat. It's a good cat if it catches mice."

1980s
Reagan-Thatcher
The conservative leaders of the U.S. and U.K. come to symbolize the retreat of the state and the ascendancy of Milton Friedman's monetarist theories.

1989
Fall of the Wall
"Mr Gorbachev, tear down this wall," Reagan said in Berlin in 1987. Two years later it comes about – a potent symbol of the end of socialism.



Tom Stoddart/Getty Images; Rex Features; Shutterstock

Sarbanes-Oxley

The U.S. Public Company Accounting Reform and Investor Protection Act of 2002, commonly called Sarbanes-Oxley after its political sponsors, Paul Sarbanes and Michael Oxley, was passed after several large corporate and accounting scandals.

The law created the Public Company Accounting Oversight Board (PCAOB), to oversee and discipline accounting firms. It also covers auditor independence and corporate governance.

Supporters say Sarbanes-Oxley has helped restore public confidence in corporate accounting. Critics say its complex provisions have blunted the U.S.'s competitive edge.

A 2005 paper by Ivy Zhang of the University of Rochester, NY, estimated the total cost of Sarbanes-Oxley to U.S. business at $1.4 trillion (€900bn).

In 2008, the *Wall Street Journal* said: "The new laws have neither prevented frauds nor instituted fairness. But they have managed to kill the creation of new public companies and damage entrepreneurship." But official statistics don't show any great reduction shift created by start-ups after the act was passed.

The U.S. Supreme Court is to hear a challenge to the law's constitutionality.

But global stimuli are likely to prove short-term for two reasons: first, because their continuation may ultimately inhibit the very economic growth they are supposed to promote; and second, because many governments, having assumed mammoth debt, need to balance the books.

Herhalt says there is evidence that, in the long run, too much state spending could "take away the engine that drives the economy". This debate is politically charged. Opponents of state pump priming often cite the Rahn curve, which seeks to prove mathematically that once state spending exceeds 25% of GDP, it restricts economic growth. The curve has a beguiling simplicity but if history teaches us anything, it is that political economics are seldom clear-cut.

A question of expediency

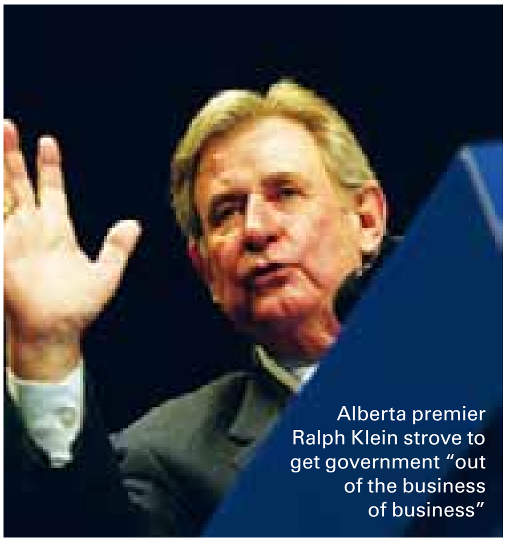
The projections for many national treasuries do possess a certain stark simplicity. The Thatcherite principle that governments should be careful not to spend too much more than is coming in will haunt many finance ministers in the years ahead. Herhalt says they face two choices: "Find more revenue or cut spending." With economies wobbling, cutting spending and services seems the likelier option.

Herhalt co-authored a KPMG report, *The Wolf Is At The Door*, based on interviews with 124 civil servants in six nations. It warns that, by 2012, credit rating agencies could be pressuring the U.K. – and possibly Australia, Germany and the U.S. – to cut debt. Budgets could face severer cuts from 2011. Herhalt says the window for governments to radically rethink their organizational model and deflect such pressure could close within a year.

> *"Government cannot eliminate risk. So the question is, what is an acceptable risk?"*

It is human nature, in a crisis, to find an inspiring precedent. At the start of the crunch, the Swedish model of extracting equity, as states bailed out banks, was in fashion. The new precedent in vogue is Canada in the mid-1990s. With the government deficit at 9% of GDP and debt at 70%, Ottawa comprehensively reviewed its purpose, goals and performance, asking, as cabinet office minister Marcel Massé brutally put it: "What needs to be done by government – and what can we afford to do?"

Through a complete re-examination of the state's role, Canada axed 55,000 public sector jobs



Alberta premier Ralph Klein strove to get government "out of the business of business"

and cut federal spending by around 20% without triggering a massive public backlash. By 2000, the budget was US$12.5bn (€8.7bn) in surplus, and spending on public programs accounted for just 11.5% of GDP, the lowest in 40 years.

The lessons Massé drew from this success were that arbitrary cuts didn't always deliver as expected (they often lowered the quality of service), efficiency savings only took you so far (they might shave 4% off spending at best), and that this re-engineering was so intensive it was very hard for the state to undertake other major projects. Massé's seminars on this experience have been attended by, among others, Gus O'Donnell, the British Cabinet Secretary.

To the chagrin of theorists like Reich, the need to balance the books may persuade many finance ministers to emulate Ralph Klein, the premier of the Canadian province of Alberta, who, between 1992 and 2006, slashed spending, sold state assets and deregulated in a quest to get government "out of the business of business".

Business may bear the brunt of recessionary pressure now, but the reality behind the gloss and glamor of the G20 and G8 summits is that many of these leaders – or their successors – will have to, as JFK so eloquently put it, ask what they can do for their country. They may not like the answer. ●

1990s
Indian resurgence
Confused monetary policies and corruption in India lead to decades of stagnation. After an IMF bailout, the Rao government initiates reforms that lift 300 million out of poverty.

2002
Sarbanes-Oxley
The U.S. legislature passes an act requiring tighter accounting standards, in response to a number of corporate scandals that raised public ire.

2009
Summit diplomacy
The G20 London summit agrees US$1.1 trillion (€700bn) state funding for economies worldwide and promises tighter regulation on hedge funds and tax havens.

Justin Lane/Corbis; Donald Weber/Getty Images

Napoleon, Icarus and the paradox that kills business

What the Emperor's invasion of Russia says about corporate strategy

BY SHAUN CAMPBELL

"Let's invade Russia." It wasn't one of Napoleon's most promising ideas, but consultant Jerry Manas says a detailed analysis of that failed 1812 campaign has a lot to teach businesses.

As a manager, Napoleon was charismatic, flexible, visionary, and tough, a motivational genius who won many battles through extensive preparation. His soldiers were well-trained, knew what was expected of them and confident. His other gifts included memory ("I knew the names of officers in all the regiments"), industry (he got up early, worked hard and systematically) and *sangfroid* ("I could listen to intelligence of the death of my wife without a change of feature"). He had a touch of hubris but few shrinking violets make CEO, let alone Emperor.

So what went wrong in 1812? "Napoleon put an unprecedented amount of effort into the logistics of that campaign. He knew the Russians would adopt a scorched earth strategy, that keeping his men fed and provisioned was vital. Each man had to carry four days worth of food in his pack," says Manas. "Two things went wrong. His officers couldn't stop the men eating all their rations in the first day or two. And summer came two weeks early, which prevented the horses and supply trains from keeping up with the men. We often focus on the winter retreat from Moscow, but the army was in poor shape before it even got there."

The Icarus paradox Perhaps the Corsican suffered from what business writer Danny Miller calls "the Icarus paradox" – the higher we fly, as individuals or companies, the more likely it is that our strengths cause our downfall. In Greek myth, Daedalus made wings for his son Icarus who, exhilarated by his power, flew too close to the sun, melted his wings and plunged to his death.

Miller says the paradox "applies to many outstanding companies: their victories and their strengths so often seduce them into the excesses that cause their downfall". Among the typical Icarian "riches to rags" trajectories that Miller traces are DEC, a computer company that rose through careful craftwork but sank when that craft degenerated into obsessive tinkering; and CDC, which stunned rivals like IBM with its Cray supercomputers in the 1960s but blew its lead by developing fantastic, futuristic products that were too expensive for the marketplace.

In Napoleon's enterprise, a careful building process – calming the chaos of the French Revolution, imposing the *Code Napoléon*, defending France from its attackers – ended with the imperialist pretentions symbolized by his self-coronation in 1804. The sensible thing might have been to say, "I've conquered most of Europe, I don't need Russia", but the internal momentum of his organization – and the need to pre-empt a Russian invasion of France – drove him on.

This shows how success changes the corporate balance: the things companies are good at attract most of the resources, while vital functions are neglected. Robert Maxwell's empire proved not to be a world-class business. But Maxwell built up a profitable printing and publishing business before megalomania set in. Maxwell had always been acquisitive, and ultimately cash cows such as print were starved of investment as the strategy narrowed to focus on the big deals that, ultimately, ruined the business and many employees.

Perils of excellence It is hard, Miller says, to distinguish between the concentration of success and the narrowness of irrelevance. Managers must be alert to "the perils of excellence".

Napoleon excelled as a military strategist and risked almost everything on one venture, which no prudent CEO would ever do. By 1812, the French empire was so large – and had so many enemies – that no man, not even Napoleon, could run it single-handed. He had to delegate, but hiring had never been one of his strengths and asking brother Joseph to run Spain, soon lost to Wellington, was a blunder.

Napoleon shows how strengths become a fatal weakness as success changes organizations

Perhaps he forgot his own advice, as a believer in KISS (Keep It Simple, Stupid): "The art of war does not require complicated maneuvers; the simplest are the best, and common sense is fundamental. One might wonder how generals blunder; it is because they try to be clever." Ironically, says Manas: "There are indications he had learned from his mistakes during his exile on Elba. But it was too late. He was a workaholic and, by Waterloo in 1815, he was simply burnt out."

Learning from the Emperor

- Recognize when your business has grown so much your management structure has to change
- If a single deal could break your organization, it's a deal too far
- Consider whether success has unbalanced your business
- Listen to opponents
- Be visible to your team
- Be more imaginative when monitoring risk

For more information, read Jerry Manas's *Napoleon On Project Management* (Nelson Business) and Danny Miller's *The Icarus Paradox* (Harper Business).

Imagno/Getty Images

It's not what you know…

Managing data isn't glamorous but Conrad Wolfram, the business brain behind the new name in online search, says it could make your company work smarter

BY ROBERT JEFFERY

Accurate information has never been more crucial for cash-conscious businesses but, says Conrad Wolfram, getting hold of data is only half the battle. The real question is: how quickly can your data give you meaningful answers?

"If it takes you longer than a minute to get an answer to a straightforward question, you need a fresh strategy for getting your data out," says Wolfram, strategic director of Wolfram Research, the firm behind the famous new 'answer engine' Wolfram|Alpha (www.wolframalpha.com). "If I want to know 'What was John's incentive last quarter?', I should be able to type that in and get an answer. It should be bespoke computing.

"The problem nowadays isn't a lack of data. We've all got tons of it, either from the web or from our own internal corporate sources. But data is only one part of knowledge. The other part is knowing what to do with that data and how to get real answers from it."

Business intelligence is more than just 'nice to have'. Steve Gallagher, partner, KPMG in the UK, says: "Data analysis tools are nothing new, yet I'd suggest that businesses use 20% of their full capability. They can facilitate understanding of customer bases, hot products or new markets." Wolfram says: "You work with quantitative results and analysis far more than a few years ago. Combining publicly available information with your internal information is crucial to keeping a competitive edge."

Wolfram Research – founded in 1987 by Conrad's brother, CEO and acclaimed computer scientist Dr Stephen Wolfram – started out to market Mathematica, a computational software program used by research scientists and academics to handle complex models. The program was inspired by Stephen Wolfram's belief that all natural phenomena can be computed (a theory distilled in his bestseller *A New Kind of Science*).

Wolfram Research has gradually broadened its horizons and taken its technology to new markets, generating headlines in May with the public launch of Wolfram|Alpha, which takes the Mathematica approach to online search. "It tries to interpret the meaning of what you've entered," says Wolfram. "Then it compares it to a huge sucked-in data resource that we have curated, adding meaning and computation. It compares the two and gets you a bespoke answer to your specific question – not a list of links to other people's answers to other questions."

It's not a search engine, insists Wolfram, but the company has still provoked a reaction from Google, whose co-founder Sergey Brin was a 1993 Wolfram intern. Google Scholar and Google Squared, two new offerings, are similar to certain facets of Wolfram|Alpha. Rather than wade into a David vs Goliath battle, Wolfram looks to sponsorship, licensing and subscription models to become profitable, not market share.

Preparing for future growth means Wolfram is one of the few technology companies hiring. While it doesn't use Google-style algorithms to sort job applicants, its approach is unconventional. "We have an argumentative, questioning culture," says Wolfram. "We are more interested in raw intelligence we think is applicable, not necessarily conventional wisdom and knowledge. We give people a set of questions to choose between, in areas they aren't claiming to apply for, and let them figure out what they want to answer."

Whether Wolfram's software can tell it how to succeed where a slew of rivals has failed isn't clear. But the business plan – "to take all systematic knowledge and make it computable" – suggests it is in for the long haul. And Wolfram believes CEOs increasingly understand just how fundamental business intelligence can be: "Organizations that might have been happy with how they were doing things are completely rethinking them in this period of change. And that includes the way they analyze and compute. They've been shaken out of the traditional way of doing things." ●

"If it takes you longer than a minute to get an answer to a straightforward question, you need a fresh strategy for getting your data out"

Go further

Visit the Wolfram site at *www.wolfram.com.* For more on business intelligence, see *www.kpmg.co.uk/advisory/performance/fm.*

aob

Getting to grips with the real cost of going green; execs blog on change, arguing and dating

need to know

Sustainable supply chains

Why would I want to go green now?
Supply chain transformation is back on the agenda as businesses start scrutinizing costs. But if you're rethinking your supply chain to make it more efficient, why not enhance its sustainability at the same time? "In this financial situation, it's going to be tough for companies to pay more money to be environmentally friendly," says Paul McCann, vice president Asia of supply chain management company Smurfit-Stone. "Companies will start with opportunities where becoming more environmentally friendly also saves them money."

Who's leading the way?
Wal-Mart is introducing carbon footprint labelling on all its products within five years, and has told its global suppliers to sign up to strict sustainability guidelines. IKEA suffered a PR backlash earlier this decade after being implicated in child labor scandals, but its IWAY program for suppliers has since earned it green kudos. According to an E2Open survey, 90% of supply chain directors expect their boards to green up supply chains.

Is this just about carbon footprints?
Footprints and 'food miles' are consumer-facing signs of sustainability, but animal welfare, labor standards and product safety are equally pressing issues which have the ability to turn into full-blown crises. As supply chains become increasingly global, focusing on the detail gets harder but regulation is on the rise too: the EU is planning carbon guidelines for food and drink retailers by 2012. There are also signs China recognizes its manufacturing sector needs to be more transparent over pollution.

How do I get started?
Building sustainability into an ongoing supply chain transformation is the best way. Not only will it protect you from unpleasant PR, it will help you respond to new regulations, build brand value, reduce operating costs and exploit opportunities.

execs online

The edited highlights

"Everyone feels like change is in the air. We've all heard the buzz words – 'the new normal' or 'reset' – and for the most part I think it's a good thing. It's about getting back to the things in life that really matter – being fiscally responsible rather than buying more than you can afford, spending time with loved ones, and re-evaluating priorities."
Bill Marriott, chairman and CEO of Marriott International (blogs.marriott.com)

"Late for meeting. Good news is client I am meeting with is about 20 cars behind me."
Kel Kelly, CEO of Kel & Partners marketing agency, on Twitter

"Finding the right job is a lot like dating. It's hard until you start, then it's great till it's not. Then it's frustrating as hell until you get it right. But when you do, it all comes together."
Mark Cuban, owner of the Dallas Mavericks and chairman of HDNet (blogmaverick.com)

"I had a boss who loved to stop me in meetings and say: 'Dave, you're arguing with yourself.' I viewed it as a strength. Sometimes I think I should have replied: 'Well, I need to argue with someone who can hold their own against me, boss.'"
Dave Kellogg, CEO of software developer Mark Logic (marklogic.blogspot.com)

"Investor commitment is important... when the going is good, everyone expresses faith in the India story and your business. When the chips are down, investors' mettle is tested. In the last meltdown, many VCs shut up shop and left India."
Sanjeev Bikhchandani, CEO of Info Edge India (bikhchandani.blogspot.com)

Find out more

Being the Best: Thriving, Not Just Surviving
This report focuses on how finance functions are faring and how their priorities have shifted. The report can help finance support business management more effectively.

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