

Issue 8 / November/December 2011

Agenda

Insights into growth, performance and governance



cutting through complexity



Can Xi Jinping make his country innovate?

Why creativity is the central challenge facing the world's most powerful economy

p8 IPOs

What smart companies know about going public

p18 Strategy

Why the outsourcing revolution is far from over

p22 Growth

Ten ways to transform the way you run your business

p13 Coaching

Managing your leaders: lessons from the NBA





In this new era, businesses need to transform to compete.




Almost every company we work with has changed its business model. Many factors can drive these transformations.

We take a broad view on page 22, where we explore ten ideas that could help you kick-start the transformation of your business. For some, collaboration may be the key. For others, it is making the right case to use the cloud to change their business models.

Take the specific area of risk. Many directors thought they knew all about risk, but the financial meltdown taught them otherwise. We explore this issue in depth on page 26. Other times, regulation can spur change. We have yet to see the full effects of new rules like the US Dodd-Frank Wall Street Reform and Consumer Protection Act. But we do know that they have implications for every business – not just financial services companies in the US.

And transformation isn't just for companies – countries need to rethink their strategies too. As we discuss on page 14, China's new generation of leaders need their country to flex its innovation muscles to maintain its economic momentum.

At KPMG Advisory, there has been a change of leadership: my gifted predecessor Alan Buckle is now serving as our Global Deputy Chairman. But what we do remains the same – we still want to help you cut through complexity to create and preserve the value of your business. 

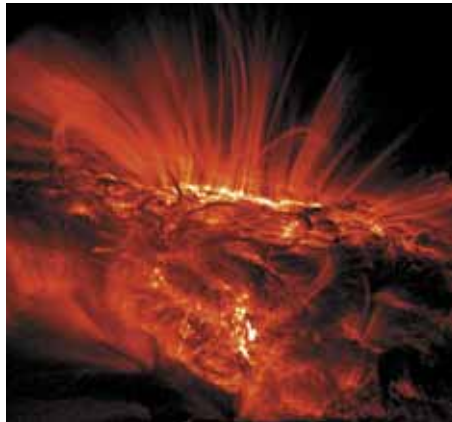
Mark Goodburn
Global Head of Advisory, KPMG

Contents

26

Unnecessary risk

Your business might not be packed with daredevils. But it still pays to understand risk management – and that starts at the very top



22

Great minds

Sunspots were discovered by four scientists simultaneously. Do you rely too heavily on a lone genius for your innovation?

12

Functional foods

Japan's Matsuya restaurant chain has adapted to a new economic reality – but a relentless focus on cost hasn't stifled its ambitions



14

Inside

04 Foresight

CFOs come of age; is the Arctic the next great business frontier?

06 Ones to watch

Five leaders planning to create the next emerging market giant

08 Best practice

IPOs: why it pays to address the basics before you go public

12 Acumen

How austerity inspired a Japanese restaurant chain to rethink the detail

13 Learning curve

Phil Jackson and the Chicago Bulls route to managing stellar staff

14 Keys to success

China's future growth lies in Xi Jinping's hands. No pressure then...

18 The great debate

Is outsourcing over? A panel of specialists considers the facts

21 Competitive edge

How IBM turned water stress into a recipe for guaranteed liquidity

22 Ten issues

Ideas to help you genuinely transform your business

26 The big issue

Why risk is too important to be left to business leaders

30 Left field

Should *Saturday Night Live* be essential corporate viewing?

31 AOB

Getting to grips with complexity – with a little help from Barbie

Cover photos: Fredrik von Erichsen/dpa/Corbis; Jonathan Daniel/Getty Images. This page: AP/Press Association, SSPL/Getty Images, Sven Hagolani/Corbis



Agenda: Insights into growth, performance and governance is published by Haymarket Network, Teddington Studios, Broom Road, Teddington, Middlesex TW11 9BE, UK on behalf of KPMG International. Editor Paul Simpson Managing Editor Robert Jeffery Production Editor Sarah Dyson Art Editor Jo Jennings Staff Writer Katie Jacobs Picture Editors Dominique Campbell, Jenny Quiggin Production Manager Trevor Simpson Senior Account Manager Alison Nesbitt Group Art Director Martin Tullett Editorial Director Simon Kanter Managing Director, Haymarket Network Andrew Taplin Reproduction Haymarket Prepress. No part of this publication may be copied or reproduced without the prior permission of KPMG International and the publisher. Every care has been taken in the preparation of this magazine but Haymarket Network cannot be held responsible for the accuracy of the information herein or any consequence arising from it. Views expressed by contributors may not reflect the views of Haymarket Network or KPMG International or KPMG member firms.

Foresight



Why CFOs are more than just scorekeepers

How a focus on growth, and the long-term vision of emerging markets companies, is shaping the role of the finance chief

When Chris Liddell, the CFO who prepared General Motors for the biggest IPO in US history, began taking stock of the car-maker's finance function after his 2010 appointment, he quickly identified the type of department he wanted to power future growth.

Too often, said Liddell, "[finance functions] are scorekeepers. They're putting numbers together without necessarily converting that into information, and they often lack the time to really think about insight. The urgent tends to crowd out the important."

In tough times, a focus on cost containment and accurate reporting is

essential. But as companies focus on innovation and growth, CFOs need to play a more strategic role. And finance chiefs who steered a clear path through recession are being rewarded with the chance to transform the finance function.

A New Role For New Times, a 2011 KPMG/CFO Research survey of senior finance executives in large multinationals, found that 62% expected finance to have a more prominent role in their company in five years. Greater support for line-of-business management and business growth were seen as the two areas with the most opportunity for CFOs to take greater ownership.

"The coaching and guiding role of the CFO became more prominent in the financial crisis," says Jochen Pampel, Global Head of Financial Management for KPMG Europe and a partner in the German firm. "At the same time, new organizational structures, enabled by new technology such as cloud computing, are elevating the CFO." Pampel says CFOs

are increasingly able to empower local managers to run day-to-day processes through devolved technology, freeing them to hone in on finance infrastructure, KPIs and assurance. They are using business modelling to identify opportunities, offering insight to CEOs and being proactive about predicting forthcoming compliance challenges. Many are also assuming responsibility for sustainability, especially carbon auditing.

The Kellogg's finance function sets business units targets for innovation, not just cost. Steel giant ArcelorMittal has asked CFO Aditya Mittal to assume more responsibility for its European business, which is key to its future growth. Benson Tsang, CFO of Chinese education giant ATA, says his role is about adding value – he says CFOs are increasingly asked to be "deputized CEOs." Successive surveys have found they are more likely than ever to hold MBAs, and women are no longer a rarity in the role.

Liddell coached his finance staff on how to present concise factual information of strategic value to the board and external investors. As a result, he said: "We can spend on engineering strategically versus altering it based on the economic conditions we find ourselves in. In the past, we'd launch

62%

of senior executives expect finance to have a more prominent role in their company in five years

projects in the good times and kill them in the bad, which is a terrible way to run engineering organizations."

Pampel says CFOs should appraise how they can utilize technology to change their role, and align their insights to business strategies. For Western businesses, he believes, the next challenge will be to get in tune with partners and targets from emerging economies. "Chinese companies have 10-, 20- or even 30-year plans and it is a challenge to talk to them and adjust to a different way of thinking. Many European companies have forgotten how to think long term."

Opening gambit

A business that makes nothing but money is a poor business
Henry Ford

Leading Edge

by Professor Klaus Meyer



BRIC multinationals would be smart to ape Korea's moves

Despite the hyperbolic fanfare that surrounds emerging economies, it is still hard to name major multinationals from the BRIC countries. China's Haier, Russia's Gazprom and Brazilian Embraer have all caused global ripples. But it remains rare for such companies to experience significant growth outside their region.

The global list of top companies will soon feature new faces from India and China, however. Outbound M&A from emerging economies is gaining pace: it quadrupled in India in the first half of 2010, while the UN says outflows from emerging economies grew six-fold from 1993 to 2008. Since recession blunted the investment appetites of Western multinationals, BRICs have been the engines of M&A growth.

Indian and Chinese companies usually take a long-term view of their acquisitions. They may even use them to test the water. It's not surprising many first-time Western acquisitions fail, when companies are operating in an alien environment. Yet this shouldn't be the end for a cash-rich, emerging market multinational that can look beyond maximizing short-term returns.

Parallels can be drawn with the experiences of Taiwan and South Korea. Both economies grew rapidly at the end of the 20th century through high-tech expertise. But where Korean companies such as Samsung and LG developed beyond Asia, the only Taiwanese brand widely recognized is Acer. Taiwanese companies concentrated on building manufacturing capability, not brands.

It will be challenging to follow the Korean route, investing in R&D without losing focus on cost and quality. Japan has been through the same cycle, moving from low-cost to market-leading products, particularly in electronics. Like the Japanese, India and China must define their national brands if their companies are to develop their own.

Klaus Meyer is Professor of strategy and international business at Bath University and co-author of International Business.

Northern lights

Coming in from the cold: could the Arctic be the next great growth area for business?

In March 2011, Canada's National Energy Board gave permission for a pipeline connecting natural gas fields in the Beaufort Sea to ports in Alberta, to serve the North American energy market. The decision was little noticed beyond the sparsely populated local community, which it had fiercely divided. But businesses everywhere may soon become more interested in the Arctic region.

The Mackenzie Valley Pipeline will eventually carry 18.5 billion cubic metres every year. And it won't be the last major development in Canada, says Laurence Smith, Professor of geography at UCLA and author of *The New North: The World in 2050*. Smith believes the eight Northern Rim countries – Denmark, Iceland, Sweden, Finland, Norway, Russia, Canada and the northernmost US – will draw migrants attracted by their strong demographic mix and economies buoyed by development of the region's natural resources.

"By the middle of the century, while much of the world struggles with climate change, the situation in the Northern Rim will be different," says Smith. "Maritime activities, including shipping of natural resources, will be more viable across the region, and hydrocarbon development will flourish."

China has already explored the possibilities. As well as suggesting it will stake a claim to the future of Arctic exploration, it has also invested in hydrocarbon generation in Greenland. Norway's Tschudi Shipping Company is working to finally open the Northeast Passage, a shipping strait that links northern Europe to Asia via the Arctic and could revolutionize maritime transportation.



NEW RULES

No.2
The manager as conductor

Albert Einstein told us all things were relative. But business hasn't always followed his teachings, says Justin Menkes, author of *Better Under Pressure*. Too often, CEOs engage in reductionist thinking, isolating problems and managing them in a top-down, old-school style. But the best leaders resemble conductors, setting staff challenges but also interacting with them to define the tempo of their problem-solving. Cisco CEO John Chambers has linked remuneration to collaborative ability. Even if you don't formalize such traits, you could benefit from what Menkes calls "co-creating success".

Ones to watch



Anand Mahindra

56, Managing Director, Mahindra & Mahindra

The giant Indian conglomerate, best known for its trucks, has enjoyed strong growth but can't crack North America. Will a "global SUV" help?

The story so far Mahindra began in steel, but its iconic trucks and agricultural vehicles (it is the second-largest domestic auto manufacturer) pushed 2011 revenue up 18% to US\$8.7bn (€6.1bn), buoyed by a strong auto component division. Since Harvard-educated Anand Mahindra, the grandson of one of the company's co-founders, took charge in 1997, the group has experienced huge growth and some setbacks. The company will export 17,000 units in 2011, but its TR40 utility cannot yet be sold in the US, where its dealer network is stymied by ongoing legal issues.

What's next Mahindra can point to strong demand in Africa, and its takeover of Korea's SsangYong Motor will introduce higher-end vehicles through economies of scale ("You don't have to be a gorilla to produce new, nimble cars," says Mahindra). His pet project is a "global SUV" made in India and due to be unveiled this year, but the company may rely less on its automotive division in future: Tech Mahindra is the largest IT supplier to Indian telcos and it will invest in business process outsourcing, while its finance arm is keen to offer mutual funds.

► **He'll succeed if...**

The African market for cars grows as expected. The global SUV drives revenue and Chinese imports don't dent demand from India's middle class. Diversification into IT and outsourcing boosts profits.

What is on their to do list?

These five leaders plan to create the next emerging market multinationals – but their strategies could hardly be more different



Liang Wengen

53, Chairman, Sany Heavy Industry

Sany's cranes dominate skylines from Shanghai to Stuttgart as the heavy industry group seeks to become a global market leader renowned for quality. Chairman Liang Wengen, who once ran a state-owned arms factory, has a reasonably high profile, representing China's engineering sector in talks with US government and business leaders.

The story so far With R&D facilities in the US, India and Germany (where it has the first Chinese manufacturing base), Sany's roster of cranes, pumps and excavators is matched by a flair for PR (it helped rescue efforts in Chile and Fukushima). Liang, who founded the company in 1989, has started a program of "complete localization" to generate 50% of revenue from outside China by 2015. At present, only 10% of sales are from overseas.

What's next Sany has invested US\$140m (€100m) in Germany and is targeting Africa, Brazil, Indonesia and Russia. The group has trumped rivals by launching the world's biggest crawler crane and has significantly increased capacity: by 2012 it could manufacture as many as 80,000 excavators. Sany has been financially innovative: listed in Shanghai, it is valued at US\$15bn (€10.5bn), has just raised US\$3bn (€2.1bn) in an IPO and offers credit to customers.

► **He'll succeed if...**

He considers strategic acquisitions. The domestic market is resilient as Sany grows overseas. Product quality ensures that, as Liang hopes, "Made in China commands the respect of the world"

AP/Press Association; AFP/Getty Images; Bernd Settnik/Picture-alliance/ZB



Emilio Azcarraga Jean

43, Chairman, Grupo Televisa

The “Mexican Rupert Murdoch” has turned round the fortune of his family-owned media company. Now he has his sights set on the US – if he can resolve his dispute with the world’s richest man...

The story so far Emilio Azcarraga Jean boasts one of Mexico’s most prominent business names. His father, Emilio Azcarraga Milmo (“El Tigre”) made Grupo Televisa into Latin America’s largest media empire. When El Tigre died in 1997, his 29-year-old son inherited US\$1.3bn (€900m) of debt. He rebuilt the group, embracing editorial independence and telenovelas, including *Una Familia Con Suerte* (A Family With Luck). In 2010, satellite subscriptions closed in on broadcast income as revenue soared to a record US\$4.6bn (€3.2bn).

What’s next With 16% of the US population of Hispanic origin, Azcarraga Jean secured a 5% stake in Univision, the largest Spanish language TV network in the US. “It’s a message that we’re not going to stay put,” he says. Univision already airs Televisa shows, including hugely popular soccer matches, and will now move them onto smartphones and iPads. For Grupo Televisa, the elephant in the room is Carlos Slim, the world’s richest man, who owns Latin America’s largest pay-TV operation via his Telmex Internacional network. Regulators have blocked Slim’s entry into the Mexican market and, in protest over this and other issues, he has pulled all advertising from Televisa amid an angry war of words.

► He’ll succeed if...

He sees off challengers – he owns only 15% of the group – and can handle Slim’s eventual entry into Mexican pay-TV. Televisa finds new markets for its syndicated shows and expansion into the US pays off.



David Constable

48, CEO, Sasol

Though he only took office in June, David Constable has a clear brief: help the South African oil major grow globally and exploit its proprietary technology. With 30 years experience of engineering, Constable previously ran operations for infrastructure giant Fluor.

The story so far The Fischer-Tropsch process is obscure even to students of chemistry. But to South Africa’s Sasol, it’s a passport to riches. The company makes gasoline from coal and natural gas – and racked up US\$2.3bn (€1.6bn) profit on US\$17bn (€12bn) sales in 2010. At home, Sasol produces 190,000 barrels a day of diesel from coal, but its ambitions lie abroad. In 2011, it made its second shale gas acquisition in Canada, where Fischer-Tropsch will help it free “stranded gas” that can’t be reached by pipelines.

What’s next Constable, who replaced Sasol veteran Pat Davies, is the first outside candidate to become CEO. He will benefit from Davies’ focus on cost and cash, and a capital spend of US\$4.5bn (€3.1bn) in 2011, largely in shale gas. A Chinese project could add 90,000 barrels a day to output. But Shell – which has its own proprietary Fisher-Tropsch technology – could enter the fray.

► He’ll succeed if...

His contacts and media savvy can lift Sasol’s profile in the industry. Oil majors stay away from stranded gas reserves. Public concern over ‘fracking’ shale gas techniques doesn’t hinder expansion.



Ahmet Nazif Zorlu

66, Chairman, Vestel

Owned by billionaire and former high-school dropout Ahmet Nazif Zorlu, Turkish home appliance and electronics manufacturer Vestel is looking to significantly expand overseas, using acquisition, innovation and organic growth to build up its brand.

The story so far Once a bed linen manufacturer, Vestel was acquired by Zorlu Holdings in 1994. After a radical change of focus, Vestel has become a US\$3.5bn (€2.54bn) company and Turkey’s largest exporter, with 76% of sales now overseas. The group has acquired brands across Europe such as Finlux, Luxor, Servis and Merloni. But selling under other brand names means few consumers have heard of Vestel even though it makes 20% of Europe’s TV sets.

What’s next? For Zorlu, the key is technological innovation. Vestel has upped R&D staff by 60% in five years and spent US\$50m (€36.3m) on R&D in 2010. In September 2011, it premiered a TV which connects to BitTorrent servers, allowing users to surf the internet and share multimedia content. Diversification into the games market is planned – the company makes the set-top boxes for Google’s Android. Zorlu also has ambitious plans to boost home appliance exports still further and enter new markets.

► He’ll succeed if...

New innovations help Vestel compete with low-cost rivals in the Far East and generate profit on low-margin consumer electronics products. Vestel establishes a strong brand presence outside Turkey.

THE COMPANY WILL BENEFIT FROM ECONOMIES OF SCALE: “YOU DON’T HAVE TO BE A GORILLA TO PRODUCE NEW, NIMBLE CARS,” SAYS MAHINDRA

SEVEN ISSUES YOU MUST TACKLE BEFORE YOUR IPO

The best way to ensure your flotation doesn't sink is to think long, hard and critically about everything from resources to pricing and governance. Get it right and the rewards are immense

There is nothing new about the idea of selling shares to fund growth. In 1602, the Dutch East India Company issued stock and bonds to exploit its monopoly of the spice trade in the Maluku Islands and grow the business partly by waging wars and founding colonies. Four centuries later, IPOs remain a stalwart of corporate life. This year will probably see more new listings than at any time since 2007, due to resurgent faith in the economy and the return of unworked capital withdrawn during the financial crisis. Such hefty new listings as LinkedIn and Glencore show how keen the appetite is for new floats. The path from private to public is not necessarily straightforward or smooth so here are seven issues for you to consider.

1 Be realistic

"The main thing we find," says Linda Main, Head of KPMG's Capital Markets Group and a partner in the UK firm, "is that companies underestimate the time and effort involved in an IPO."

Main points to KPMG research which shows that 62% of executives and 81% of financial directors at companies seeking a listing spent more than half their time on the IPO. And 40% said the process took significantly longer than anticipated.

"We would advise companies considering an IPO to look into options earlier rather than later," says Main. "There is a lot of planning and the process is a considerable drain on resources."

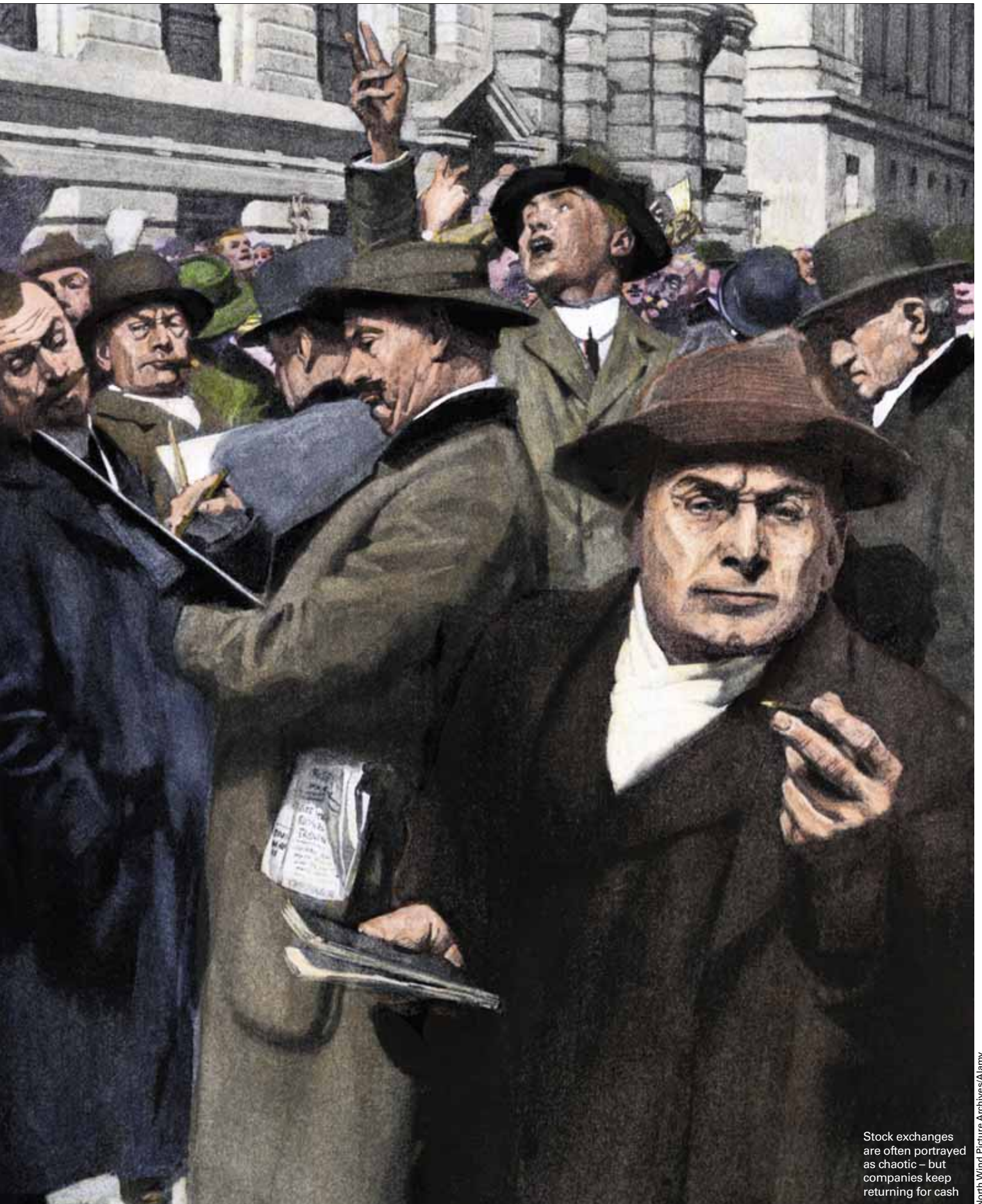
Manfred Hannich, KPMG's Global Head of Accounting Advisory Services and a partner in the German firm, agrees: "It's

not simply an underestimation of how much internal resource will be used by the process but an overestimation of the company's own resources.

"Things may be slow in the beginning but it's typically a five- to six-month process and some companies may find themselves tied up in discussions with investment banks, lawyers or media strategists."

2 Step up for the step change

Companies looking to float can be taken aback by the step change required in reporting and communication. "There's a need for much more formal documentation," says Main. "Things have to be much more structured. Minutes, documents, and records need to be prepared with people who are not familiar with the company in mind. Other issues, such as being more ►



Stock exchanges are often portrayed as chaotic – but companies keep returning for cash

North Wind Picture Archives/Alamy

Best practice

“An IPO is the best way for a company to access significant amounts of capital and retain its independence”



Going public can force reporting requirements, and accountability, onto ill-prepared executives



careful and making sure you don't accidentally release price-sensitive information, will be completely new”

KPMG's research revealed that more than 60% of companies that floated considered that, with hindsight, upgrading

their financial reporting would have enabled them to review the organization's operating performance more efficiently. More than 70% upped the head count in their finance department because of the listing process.

66%

Asia Pacific's share of global capital raised by IPOs in 2010. North America's share was 16%

3 Are you really ready?

The combined challenge presented by due diligence, disclosure and transparency standards and the necessity of having robust corporate governance systems in place may prove too much for a company to list in the near term. Hence the importance of a timely investigation of whether an IPO is really feasible.

“It's important that an IPO readiness review should be conducted,” says Hannich. “After this scan, you can formulate a list of to-dos, efficiencies and changes that must be made. The scan can help to identify potential medium- or long-term problems, some of which can be tackled after the listing.”

The shortcomings that could be highlighted would include a lack of formal risk management, problems with tax

structures or weaknesses in financial reporting. “You need to make sure you're ready to go before you start the process,” says Hannich. “If you have to delay because of internal issues once you've got an investment bank on board that has seen a window, they are not going to be happy. Once you've started on this route, you can't just stop.”

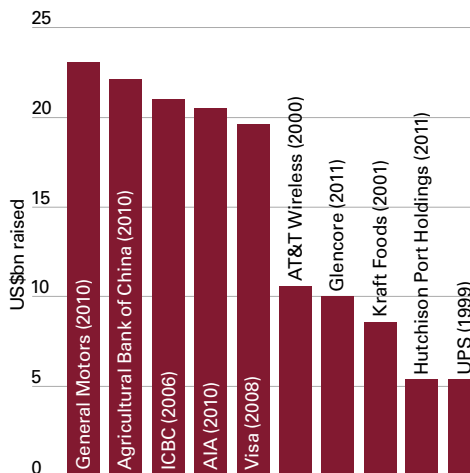
Research by MIT Sloan School of Management has identified that certain business models are far more attractive to investors than others. In *The Business Models Investors Prefer*, Peter Weill, Thomas W. Malone and Thomas G. Apel point out that innovative manufacturers (such as Apple) and companies that

leverage IP such as trademarks or patents (dubbed “IP landlords”) consistently outperform manufacturers, retailers and financial companies in IPOs. Such favoritism meant, for example, that over 12 years, the returns for different business models varied from 145% to 240%. The research does raise the question: will the business model you list with excite investors over the next decade?

The hype surrounding IPOs can mislead. Only a certain segment of the investing audience is happy to accept the heightened risk of investing in a company with no public track record. That robust approach to risk is often married to an expectation of higher rewards.

The capital game

The 10 largest IPOs in history



4 Why are you floating?

Such tricky nuances do raise the question: why float in the first place? There are other ways to raise funds: bond financing, whether by private issuance or through the open markets; old-school bank borrowing or private equity.

“The bond markets are good at the moment,” says Hannich, “but an IPO is the best way for a company to access significant growth-increasing capital without being dependent on any one entity. There can be a combination of instruments – we're seeing that with Facebook, for instance – but by accessing the stock markets, management can really stay in control.”

Activist shareholders can become a nuisance for public companies, but the



With an average return from IPO of 28.4%, Latin America – led by Brazil – had the best-performing IPOs in the world in 2010

freedom afforded by a listing is, Hannich maintains, invaluable compared with being in hock to a bank or other source of finance. “It really has to be the end goal, although other forms of finance can be used to take you there,” he says.

“An IPO preserves a company’s independence, and may increase the power of the CEO by allowing the eventual exit of venture capitalists or other financial backers,” says Jay Ritter, Professor of Finance at the University of Florida. But he warns: “A company might be able to achieve a higher value in a trade sale if it is in a business where the economies of scale that a larger organization could realize are high.”

Avoiding, or even aborting, an IPO when markets turn south may not always be bad news. In 2010, Merlin Entertainments – the world’s second largest visitor attraction group – abandoned a planned IPO due to market turbulence.

1,400

The number of IPOs worldwide in 2010, worth a total of around US\$300bn (€206bn)

The company’s portfolio, and its track record of delivering steady growth, meant it was still able to refinance and brought in private equity firm CVC – which took a 30% stake – to back expansion plans.

5 Location, location, location

“There’s a lot of cash out there,” Hannich says, noting there are “great consumer markets” burgeoning in Asia and across other emerging economies. “Companies from the ‘old world’ are tapping into those markets, whereas it used to be the other way round. Even though the IPO market in the US is good, there are deep pools of liquidity in other parts of the world.”

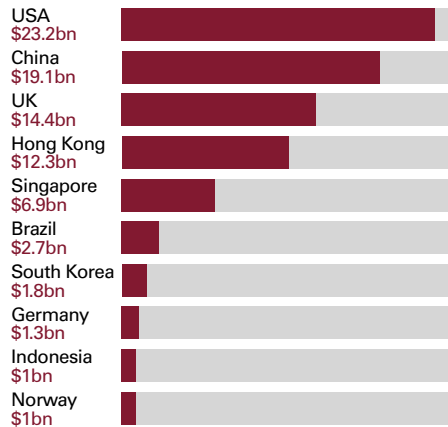
In June 2011, Samsonite International made its debut on Hong Kong’s stock exchange, raising US\$1.25bn (€860m). Prada also raised US\$2.14bn (€1.47bn) in Hong Kong, floating 20% of its shares. “If the bourse represents a market, we should go to a bourse where things are happening,” reasoned CEO Patrizio Bertelli. Hong Kong was the biggest market for IPOs in 2009 and 2010, and may well be so again in 2011.

Going public usually causes widespread change, especially within the management structure. If foreign markets are selected, management may need to relocate to that country to maintain close proximity to the investor and analyst community.

The listing leaders

IPOs by country of origin, 2010
Source: Renaissance Capital

General Motors’ US\$16bn (€11.6bn) float was the only US company in the top ten IPOs in 2010. Chinese firms accounted for 25% of deals in the US.



6 Is the price right?

Samsonite’s offering, which was priced at the low end of downwards-revised guidance, slipped 10% in initial trading and ended its first week down 7%. Compare that with LinkedIn’s US debut in May and you can see the enormous differences in companies’ immediate share performance. Priced at US\$45 (€31), LinkedIn’s shares opened at US\$82 (€56) and soared to US\$122 (€84). A month later they had fallen to 20% below the opening price.

Such fluctuations highlight the difficulty of pricing IPOs – and the conflicting interests of investment banks. They have to value a company accurately but, as underwriters, stand to benefit enormously from an initial surge in the share price.

“From the company’s owner’s point of view, the point is to sell at the best price possible,” says Hannich. “But nobody should be so naive as to imagine that valuations from the investment bank leading the sale will necessarily meet that.”

Main says that while “it is important that you leave some upside” – who wants to invest in shares that are not expected to rise? – “where a company’s price goes up by 50% or so, that is a mistake. You’re hoping for efficiency in pricing.”

The other side of banks’ prospering from underpricing shares is that those who held shares before the flotation lose out. The worth of their holdings is diluted by more than is necessary to raise the money.

BlackRock, the world’s biggest institutional investor, has accused investment banks of giving unrealistic pricing expectations to win business, and pricing shares high to bolster commissions.

Ritter points out that around 20% of IPOs leave money on the table, meaning companies could have made more if the underwriters had boosted the price. “The problem for a company is that it has almost no bargaining power by the end of the roadshow, when the pricing occurs.”

Hannich says: “One solution is to ensure that you seek a range of independent valuations before making a final decision on which investment bank should lead your IPO.”

7 The communication challenge

Hannich says that another neglected area within companies is communication: “You’ve got to consider transparency on the internal front. For one, there’s a strain on the company’s human resources, and it’s important to have employees motivated. As well as reward, they need to be kept abreast of what’s going on. These stakeholders can get overlooked.”

“CEOs are often a little surprised at the level of detail expected of them,” says Main. “They’ve been used to a higher level of discussion – in a private company you’re not having to discuss the details with people. But when a company floats – and after – analysts will want to drill right down into things.”

Though Google’s path to its highly successful US\$2bn (€1.37bn) public launch in 2004 was a bumpy one, it was smoothed by the honesty of the company’s founders, Larry Page and Sergey Brin, who flatly stated in their IPO prospectus: “Google is not a conventional company. We do not intend to become one.” They went on to warn that they would probably invest in risky projects that might bring high rewards or none at all.

With painstaking early preparation, a realistic appreciation of the complexities involved, and a clear strategic vision, a company can enjoy significant rewards from a public listing.

“The road to an IPO is not a risk-free highway,” says Hannich. “But it leads to a new and exciting frontier.”

64%

Proportion of senior executives who told KPMG that corporate governance is their main IPO hurdle

Matsuya has redesigned restaurants to win Japan's "beef bowl" price wars



Key lessons

Learning from kaizen

1 If it ain't broke...

Matsuya staff find an optimized layout for their workspace then memorize it

2 Do it yourself

Food chain Ringer Hut now makes its own meat slicers at a fraction of the cost

3 Time is money

Each movement made by restaurant staff is calculated to increase efficiency

Ko Sasaki/The New York Times/Redux/Eyevine

Japan's chain reaction

The Matsuya restaurant group has won over frugal customers by cutting costs, not quality

Even before the March 11 earthquake, tsunami and nuclear meltdowns, Japan's economy was flat. In the two decades since the end of the nation's "economic miracle," Japanese consumers have become increasingly frugal but they are still foodies who love to eat out, so deciding how to maintain high quality at a low cost has long been a priority for restaurateurs.

One chain, Matsuya, has found a novel solution, redesigning its floor layout to ensure staff prepare food as efficiently as possible. By cutting corners in the right places, the company can reduce its bottom line and pass on the savings to the customer. Price wars can be fought and won without any loss of quality.

The restaurant serves Japanese staples: gyudon (beef with rice), curry and other meat dishes. The chain is popular enough that for much of the day it operates on a one-in, one-out basis.

"At Matsuya, our price per meal is the lowest of any chain we run," says Takuya Endo, who heads the company's efficiency drive. "If we can keep prices down, we attract more customers."

"Basically, we think about each customer as an individual, and we look to get as many individuals through the door as we can, without compromising on quality," he adds. "In order to do this, we look at layout. We address the problem of how to get good food to our customers in the easiest and most efficient manner."

For Matsuya, the efficiency drive has meant a 20% cut in the price of its staple beef bowl in the last decade and similar reductions for other dishes. As prices decrease, popularity increases. "We aim to gradually increase the amount of restaurants we have throughout Japan," says Endo. By the end of fiscal 2010 in March, the chain had 840 restaurants. And by the end of this fiscal year, it expects to have 914.

In Japanese business, this process of constant improvement has a name, "kaizen." Essentially, managers are forever looking

for new ways to cut costs. Sometimes this can work in surprising ways. Ringer Hut, a rival chain, actually hired an expert to redesign its meat slicer. This sounds counterintuitive but the slicers that were commercially available all came with attachments that Ringer Hut didn't need. By designing a slicer that just cut meat, the company saved time and money.

"We are always looking to improve the system, in terms of the materials we use to prepare the food, the way our staff work and what it is our customers want from the restaurant," says Matsuya.

Kaizen is globally famous due to the efforts of Toyota, whose cost-cutting strategy saw the company briefly become the world's largest automaker, until it was hit by the natural disasters of March 11.

The system has, Matsuya believes, saved the company a fortune. By cutting a minute of preparation time from each dish, and with 400,000 customers a day (cutting the time each customer spends by one minute saves the company 400,000 minutes), staff reductions, price cuts and healthier margins have followed.

"We don't offer the cheapest beef bowls," says Endo. "But we offer choice so we can get people through our doors. And if you have a varied menu, it's the process of preparation that becomes the difficulty."

And what can other companies learn? "There is often a feeling that quality comes at a higher price. If companies look at the process and constantly try to cut costs without sacrificing quality, global culinary culture will improve." ■

Could you manage a genius like Michael Jordan?

Maverick coach Phil Jackson used zen cool to inspire basketball's great players. Business leaders could learn a lot from his adroit handling of star employees

Sport is the ultimate meritocracy. The bottom line is blatantly obvious when the game finishes. No accounting system can massage its figures, no gloss can be spun by a PR guru. The proposition is brutal and simple: win or lose, prosper or perish.

As such, at the highest levels, sport is usually a pragmatic place not given to subtlety, subversive thinking or unconventional wisdom. Phil Jackson was a glorious exception to this rule.

He won 11 championships as coach (six with the Chicago Bulls and five with the Los Angeles Lakers). In a career spanning over two decades (he retired this spring), the figures brook no argument: 1,155 games won, with a winning record in every season. Jackson is the only coach to win more than ten championships in any US sport.

He was hardly the archetypal hard-bitten American sports coach. At the start of his book *Sacred Hoops*, he said: "The team room at the Sheri L Berto Center is the inner sanctum of the Chicago Bulls – a sacred place adorned with Native American totems and other objects I've collected... I had the room decorated this way to reinforce in the players' minds that our journey each year is a sacred quest... This is where the spirit of our team takes form".

A child of the 1960s counter-culture, who opened his mind to all kinds of alternative thinking, Jackson developed a holistic approach to management that earned him the nickname 'Zen Master'. "I figured he might become president, a well-known author or a great psychiatrist," said Jackson's college coach Bill Fitch. "I always dreamt he was too smart to become a coach".

Jackson could be esoteric but he also had a hard-wired attention to detail. The hallmark of his teams on court was a triangular offensive system devised decades before and revived by him to incorporate his stars into a supremely effective team strategy.

At Jackson's level, management is a unique task because the players, in many ways, are the organization. They may rank below him in the hierarchy, but they earn



Jackson spelled it out to his Chicago Bulls team – and let them do the job

Brian Drake/Action Images

Jackson's methods

- 1** He spliced together clips from movies – notably the comedy *Jackass* – to make his point.
- 2** He seldom raged on the touchline, telling players: "Rely on yourself because when it comes to the crunch, I'm not there with you".
- 3** He kept grounded: "Don't let victories or defeats send you high or low".
- 4** He encouraged players to meditate before big games to stay calm.

more, are more feted and ultimately do the winning and losing.

Some say that anyone could manage teams of such talent. If that were true, why not get anyone? Jackson got the best from the Lakers' stellar maverick Kobe Bryant, who he had once called "uncoachable". Michael Jordan was managed in a way that suited his talent and ego. Using the triangle offense, Jackson showed the star he had to be part of a whole and surrounded him with players who responded to Jordan's genius, rather than simply living off it. Retaining stellar employees is never easy but Jackson kept his loyal and motivated. His meticulous preparation convinced them they could consistently compete for the highest prizes.

Jackson's teams were expected to self-correct in a crisis. ESPN pundit Bill Simmons nominates an incident with the Bulls' Scottie Pippen in the 1994 play-offs as the coach's defining moment. Pippen had refused to re-enter a game against New York Knicks after Jackson chose a rookie player to make a decisive play instead of him, but Jackson didn't tear into him afterwards. "Many coaches would have abandoned Pippen," Simmons said. "But Jackson wanted to understand why the player had handled it so poorly. He figured it out, decided Pippen wouldn't do it again and moved forward". The player won three more championships with the Bulls.

Jackson instinctively pioneered a way of managing creative, clever people. His methods have recently been vindicated by Gareth Jones and Rob Goffee, two London Business School professors, whose research suggests that creative geniuses like Jordan are driven by status, want to have fun and need a lot of organizational protection. As the most successful coach in the history of American sport, Jackson gave his star employees all that and more. ■

The issue China's new leaders dare not shirk

Xi Jinping, China's president-in-waiting, will inherit a thriving economy. But analysts warn that failure to kick-start innovation could see growth falter



China is now the world's second largest economy, has just surpassed the US as the biggest buyer of PCs and yet, IMF figures show, its GDP per capita is only \$76 (€56) higher than Albania's.

The Chinese economy has made such incredible progress – hundreds of millions of citizens have been lifted out of poverty in the last 20 years – it is easy to ignore its weaknesses. Yet it is these flaws that the country's next generation of leaders, with Xi Jinping set to become president next year, are concerned by.

The 58-year-old politician, whose father was purged during the Cultural Revolution, faces sizeable challenges. Some – inequality, the rising costs of healthcare and pensions as the population ages, pollution (China emits three times as much CO₂ per unit of GDP as the US) – are familiar to the West. But China's accelerated industrial revolution faces one central strategic challenge: can the country become innovative enough to move up the value chain?

The road to what Richard McGregor, author of *The Party*, calls "market Leninism" opened in 1992 when then president Deng Xiao Ping toured the entrepreneurial hothouse of Shenzhen, endorsing a new economic strategy to

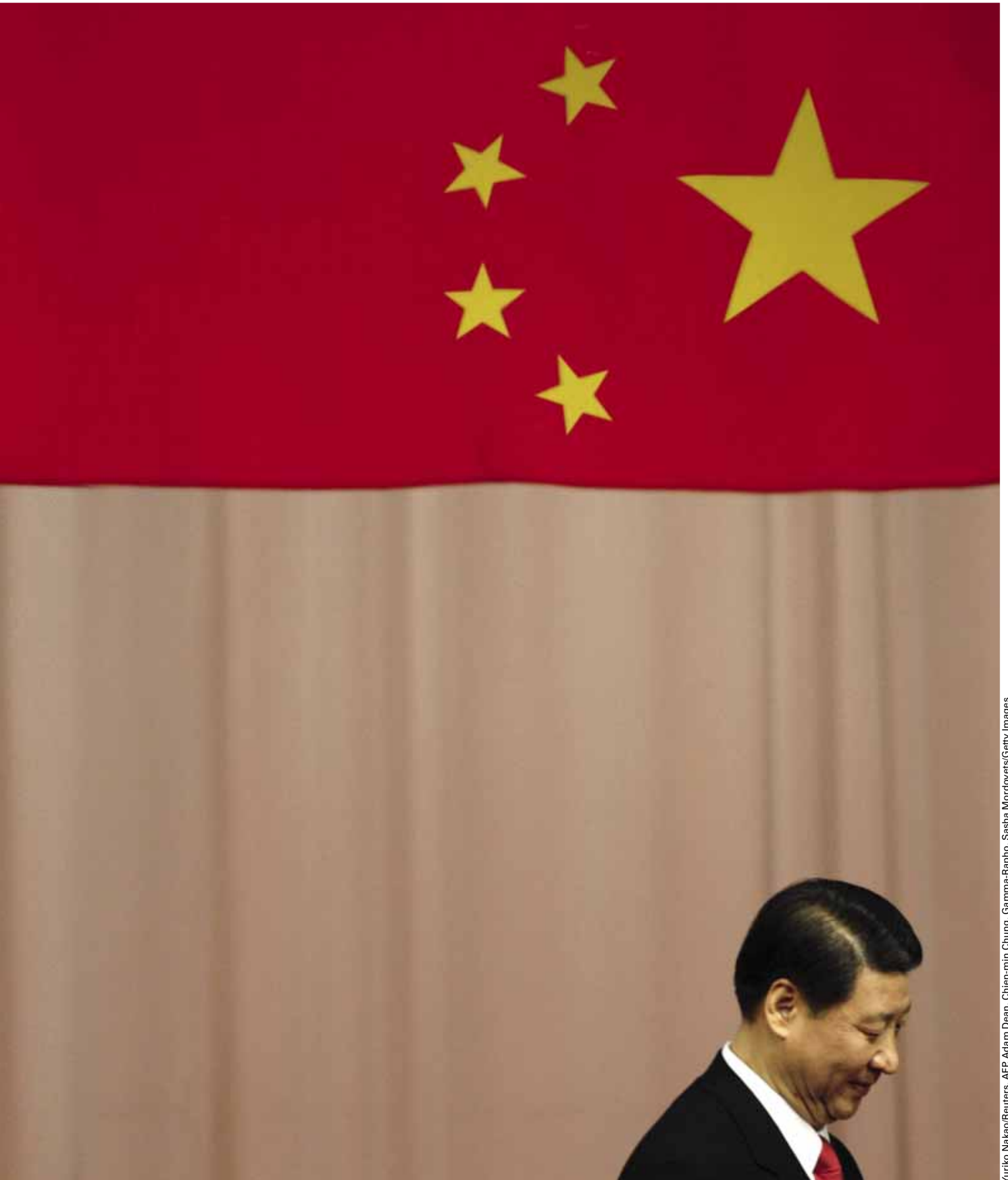
revive the moribund state sector and stimulate private enterprise.

Nine years later, China joined the World Trade Organization. "Zhu Rongji, the premier then, was very clever," says Paul French, chief China analyst for the Shanghai-based consultancy Access Asia. "He used the WTO to make the changes he wanted and, when people didn't like it, blamed the WTO." In 2007, when the global economy almost collapsed, China's government spent billions to maintain growth. The stimulus worked but the leaders know it won't succeed forever.

Edwin Fung, Global Chair, KPMG Global China Practice, says: "Traditionally, China has been known for manufacturing but the government has written a five-year plan to drive innovation. The country needs to build its brand. When you think of the US you think of innovation and Apple. With Germany you think of design, Japan quality, but what does China mean? Chinese companies will find it hard to compete globally without a strong brand."

The 2010 Interbrand survey of the world's 100 most powerful brands didn't feature one Chinese name. Optimists say this merely reflects the relative immaturity of the Chinese economy and argue that the country's products are already far more ▶

A new leader in need of a new model: China's next president, Xi Jinping



Yuriko Nakao/Reuters, AFP, Adam Dean, Chien-min Chung, Gamma-Rapho, Sasha Mordovets/Getty Images

Keys to success

The movers and shakers...

Xi Jinping		Wang Qishan		Wen Jiabao		Zhang Ruimin	
	First Secretary of the Secretariat of the Communist Party		Vice Premier responsible for finance		Premier and Head of State Council of China		CEO, Haier Group
Yang Yuanqing		Hu Jintao		Li Keqiang		Bo Xilai	
	CEO of Lenovo, China's PC giant with revenues of US\$21.6bn (€14.6bn)		President, General Secretary of the Communist Party		First Vice Premier responsible for economic development		CPC Chongqing Committee Secretary

...the facts

44	PERCENTAGE OF CHINESE GDP ACCOUNTED FOR BY SERVICE SECTOR
SIXTY-ONE	Chinese firms in 2011 Fortune 500
\$7,519	CHINA'S GDP PER HEAD
100,000,000	Chinese households earning over US\$9,000 a year (€6,112)
25%	OF CO ₂ EMISSIONS ORIGINATE IN CHINA
4.2	average days in which a new business starts up in Beijing's Zhongguancun district

sophisticated than the Western media – which dwells on every export of poisoned pet food – would have us believe. Yet others worry that China has developed a “karaoke economy” which has prospered by imitating the West, not innovating to compete with it.

The absence of a truly global Chinese brand – Lenovo, Haier and Huawei are the best known – is the country's most conspicuous economic failure, significant for the shadow it casts over China's future. McGregor says: “Officials are spending a lot of time studying how they ensure they match the West's developed economies in terms of GDP per head – and avoid getting stuck at the same level as South America.”

In 2010, America's GDP per capita was US\$47,284 (€43,325) compared to US\$14,700 (€11,039) for Argentina and US\$7,519 (€5,458) for China. One effective way of closing that gap would be for China to become much better at innovation. A shift from ‘Made in China’ to ‘Created in China’ would generate more added value. At the moment, only half the value of the country's exports are created in China – significantly less than in the US, Germany or Japan.

China's mercantilist growth model – in which huge savings are invested in manufacturing and infrastructure to drive exports which are buoyed by an artificially low exchange rate – cannot take the country much further. The IMF has warned that “failure to rebalance the growth model would imply unprecedented increases in export market share, potential overhang in capacity and stresses on corporate and bank balance sheets.”

Moving up the value chain could be painful in the medium term. As wages rise, products become more sophisticated and the service sector booms, the country's pool of cheap, disciplined labor will no longer be such a great competitive advantage.

Xianfang Ren, senior analyst at consultancy IHS Global Insight, says: “Innovation is the biggest challenge for the Chinese economy. Without breakthroughs in innovation, China's growth will reach a dead end as its demographic dividend runs out and it maxes out the global resource supply capacity. Innovations need to be supported by broad reform. One of the biggest constraints is the crowding out of the private sector by a powerful state sector that controls access to key resources. The private sector is the most innovative part of China's economy, but there has been little resource supporting its innovation drive. State-owned enterprises have the resources, but their motivation isn't as strong because they enjoy monopolistic profits without innovation.”

China's economic boom – and the stimulus package introduced in 2007 – have disproportionately benefited the state sector. In the 1990s, consumption accounted for 45% of China's GDP. By 2007, it accounted for just 36%.

Fung says: “Most state-owned enterprises have a big impact on the market because of their huge market share. It is important



Li Ning is taking on adidas and Nike. For more on China's brand new world, visit www.kpmg.com/agendaonline

they realize they need to push hard for innovation. Their increased R&D investment is a good indication of their commitment to innovation, although some people would see them as less innovative than privately owned enterprises, which are often owned by open-minded businessmen."

He does point out that encouraging domestic consumption is a major aim of the new five-year plan. But he says this rebalancing will be far from straightforward: "We have a big challenge in China. There are 1.3 billion people, but how many of them would you class as consumers? Their spending behavior is totally different."

French believes officials need a new mindset: "China wants to be a world leader in fashion. The traditional way the state would achieve that is to invest millions in a dozen fashion colleges. But sometimes, if you really want to encourage creativity, you're better off having a safety net so your rock stars and designers of the future can spend a few months unemployed and come up with something different – and the Chinese just don't understand that." *Newsweek* magazine has made a similar point: "The mix of solid engineering and marketing that goes into a brand like Nike is an art that still evades China Inc."

Many big Chinese companies – even those, like Huawei, with global ambitions – still sell to businesses, not consumers. Fung says even established foreign brands have suffered from the difficulties of grasping the intricacies of the Chinese consumer market: "When you drive a BMW, you have a good feeling, you enjoy driving the car. But in China, most managers have someone to drive the car for them. So they don't understand the brand experience."

You can't fault the Chinese leadership for effort. Spending on R&D has been up 10% every year for the last ten years and this year it will spend US \$154bn (€111bn), more than Japan. Landmark investments in space travel, genome sequencing, radio telescopes and nanotechnology prove the leaders have backed their rhetoric with money. But some worry about the quality of the country's R&D spend. Ren says: "Global brands come with global competitiveness, especially in R&D. And with the resources available to the private sector, China still has a long way to go to building a global brand."

In its journey from emerging to emergent economy, China has an array of models to choose from. Russia's swerving course – from the unfettered capitalism of the 'Wild East' to Putin's corporate state – is

"Without innovation, growth could reach a dead end as the demographic dividend and the world's resources run out"

regarded in China as a textbook illustration of how not to proceed. They are more impressed by South Korea and Japan. "The leaders have looked at the success of Japan's Ministry of International Trade and Industry and created a new body – the National Development and Reform Commission (NDRC) – which has a similar remit, although it is also about making sure the government retains control," says McGregor.

The new five-year plan makes it a strategic priority to drive such emerging sectors as energy, environmental protection, IT, advanced manufacturing and vehicles using new sources of energy. Yet in one of the conflicts that makes China's government so opaque to outsiders, the conservative NDRC often differs with the more market-oriented People's Bank of China, which has encouraged banks to support SMEs in technology and green energy.

The question for Xi Jinping is whether the state's firm grip on the economy is good for the country. McGregor says: "Nobody should underestimate their willingness to learn, their openness to useful ideas or their ability to fine-tune reforms by testing them all over the country." The recent slowdown in growth may strengthen the case for change. If China's wares and services become more attractive to its own consumers, it could help insulate the economy against shocks from the West's tortuous recovery.

Economic growth – and the pride it has inspired – has made the Communist Party very popular. This summer, China even lectured the US on the responsible way to run a modern economy. McGregor says: "The next stage of reform – unraveling the state's economic interests while protecting the Party's political interests – carries political risk. There is no easy way through that thicket, but the leaders are immensely adaptable."

Western analysts have spun many doomsday scenarios since China opened up its economy. None has yet come true. In 2012, Xi Jinping and his colleagues will have their chance to prove that market Leninism can be as innovative as market capitalism.

China's leaders are renowned for taking the long view. In the 1970s, so the story goes, the then premier Zhou Enlai was asked to comment on the effects of the French revolution of 1789. He replied, cryptically: "Too soon to tell." If the new leaders succeed, they will no doubt believe that the world's first economic superpower – the inventor of gunpowder, compasses and printing – has at last returned to its rightful place. ■



Home economic: China has pumped billions into industries like construction

Bloomberg/Getty Images

What will the future of outsourcing look like?

Businesses want suppliers to innovate, improve quality and cut costs. Our panel considers how realistic such expectations are

Nearshoring, offshoring, onshoring, insourcing... very few areas of economic activity have spawned as many confusingly similar buzz words as outsourcing. What links many of them is the idea that the old-fashioned strategy of sending work somewhere else purely to lower costs or streamline processes is hopelessly outdated.

The media has made much of multinationals, particularly in financial services, taking customer-facing tasks back in-house, often in response to negative publicity. The US has increased the cost of H1B visas used by outsourcers to send workers to overseas destinations by more than 600%. Above-average pay rises in India and China have, studies suggest, shrunk demand for outsourcers' services: GE CEO Jeff Immelt claims call centre costs between India and the US will soon be less than 10% apart.

Despite it all, outsourcing's reach – and appeal – keeps growing. With global revenue projected to reach US\$464bn (€336bn) in 2011 (see chart), IT outsourcing body Nasscom says corporate clients are spending more as outsourcers move away from BPO towards more tailored solutions. Analysts Ovum say that growth in Latin America and newer south east Asian destinations such as the Philippines is “off the scale”. Outsourcing manufacturing, an approach epitomized by Apple, attracts CEOs who are keen to fund growth strategies: 50% of Sony TVs are now made elsewhere, up from 29% in 2009.

What is the truth about the state of outsourcing? And what are the new rules multinationals need to understand as they assess their outsourcing strategies? To help clarify such issues, *Agenda* sought the views of Stan Lepeak, KPMG Research Director and a Partner in the US firm,

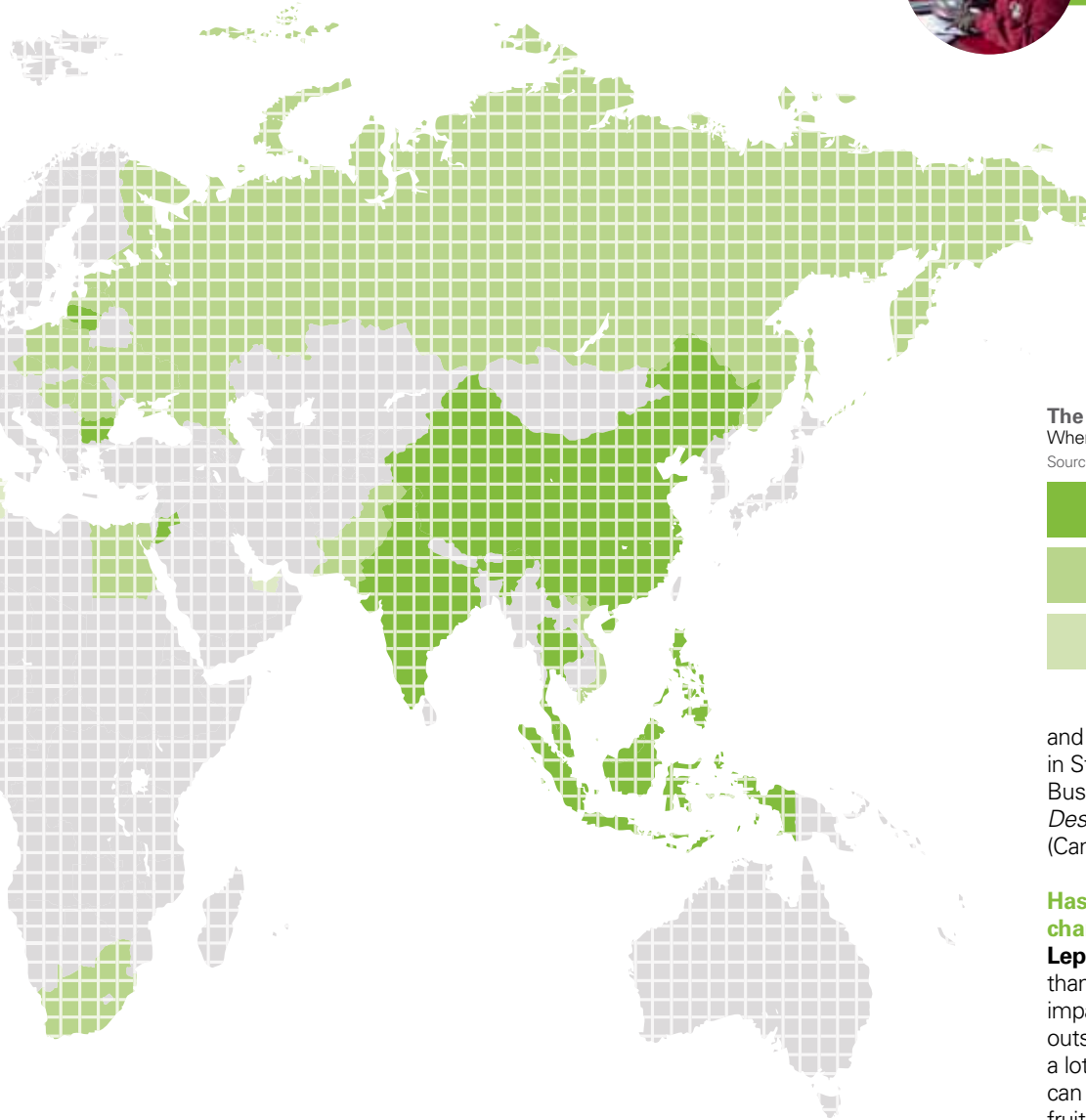
The panel

1 Stan Lepeak
KPMG Research
Director and a Partner
in the US firm

2 Michael Mol
Associate Professor in
Strategic Management
at the UK's Warwick
Business School



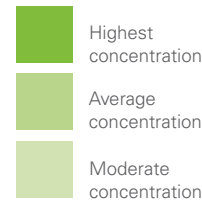
The Kenyan government hopes 120,000 people will work in BPO by 2020, with revenues topping US\$1bn (€679m)



The bigger picture

Where the world outsources to

Source: SourcingLine



and Michael Mol, Associate Professor in Strategic Management at Warwick Business School and author of *Outsourcing: Design, Process & Performance* (Cambridge University Press).

Has the rationale for outsourcing changed since the early 1990s?

Lepeak Outsourcing is still more boom than bust. We hear a lot about its negative impacts, but in the service space the outsourcing market is thriving. But there is a lot more realism out there about what you can achieve: a fair amount of low-hanging fruit has already been picked.

Mol There has been a shift in terms of what's being outsourced. Companies have become more experienced in outsourcing, and they have moved away from relatively simple, low-cost activities to the more complex. I have seen plenty of outsourcing that involves knowledge creation or improves product quality. Objectives have become broader, but there's still a lot of driving down cost.

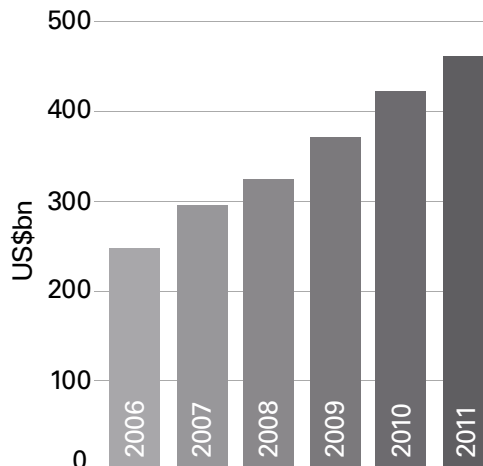
Lepeak At outsourcing's peak, companies pursued very large deals, particularly in BPO and ITO, involving massive numbers of people on a global scale. They were looking for cost savings and process improvements that were simply unrealistic. It was similar to the excitement we saw over ERP, when companies thought one massive investment would solve all their problems. In fact, that was often only the start of their problems.

But the advent of cloud computing and software as a service has changed the landscape again. Today, your HR function ▶

Outside influences

Global outsourcing industry revenue

Source: XMG Global



Rachit Goswami/The India Today Group/Getty Images

The great debate

doesn't have to be managed from three global centres – it can be outsourced to one single supplier, via the cloud, which is actually what many companies were trying to do 10 years ago.

The business world's attitude to outsourcing seems to have shifted over the past few years. How would you characterize it at the moment?

Mol In my book, I talk about the inverted U-shaped relationship between outsourcing and performance. In the 1990s, a lot of companies weren't outsourcing as much as they could, because they responded to new technology very slowly. Since then, they have been playing catch-up. There comes a point where you are doing too much, and then it's logical to ask whether you should in-source certain activities.

Lepeak It's still about saving money – with the current economic situation, that has become important again. But there also simply aren't enough people with cutting-edge skills, available at an affordable price, particularly in the West. If you're Apple, you'll probably be able to get the talent you need. If you're a utility in Oklahoma, you may have to think about outsourcing.

Which sectors and regions are particularly benefiting from outsourcing? And do you expect that to change?

Lepeak The dominant outsourcers remain in Western Europe, particularly the UK, and the US. Those countries with flexible labor markets and rapid economic growth will continue to benefit, but it also depends on your definition of outsourcing – there is a huge move to take shared services to China

via the cloud, but that isn't necessarily outsourcing as we know it.

Mol When companies select locations, they look for very specific criteria and that tends to change frequently. A year ago, people might have looked favorably at Egypt. Today, they would be more wary because of the political changes there. In another year or two they might feel differently again. Even China faces political challenges.

India is by many measures more stable, so I view that as an area of long-term growth for outsourcing, particularly with its demographics and the increasing level of education there. India has become quite creative and entrepreneurial about outsourcing. I'm not sure that's true yet in other parts of the world.

Lepeak It's not about a US company saying "I want my IT to be done out of China now". It's about saying "I want to support my growth in Asia by locating services there." Global companies are seeing their future growth in emerging economies – you can talk about shipping jobs to China, but if you're shipping goods and services there it makes sense to have support in place. That opens the door to joint ventures and long-lasting partnerships.

What sort of questions should CEOs ask before undertaking a major outsourcing project?

Mol Most companies don't give risk enough consideration. The questions that are most frequently asked are: What's our cost level? Who are we dealing with and do we trust them? They don't often ask "what happens if...?"

Lepeak Companies tend to look at the

"Companies tend to look at the potential benefits of outsourcing, not necessarily how they'll get there"

potential benefits of outsourcing, but not necessarily how they'll get there. The process of change management during that transition from a traditional model to a new one is sometimes viewed as a soft skill but it's certainly not – it's something businesses need to get better at.

More than ever, governance matters – if you're operating a shared service, are you running it as a business or a business unit? What do you want to achieve – improvements in business function or just cost savings? Outsourcing needs to be seen as an end-to-end process.

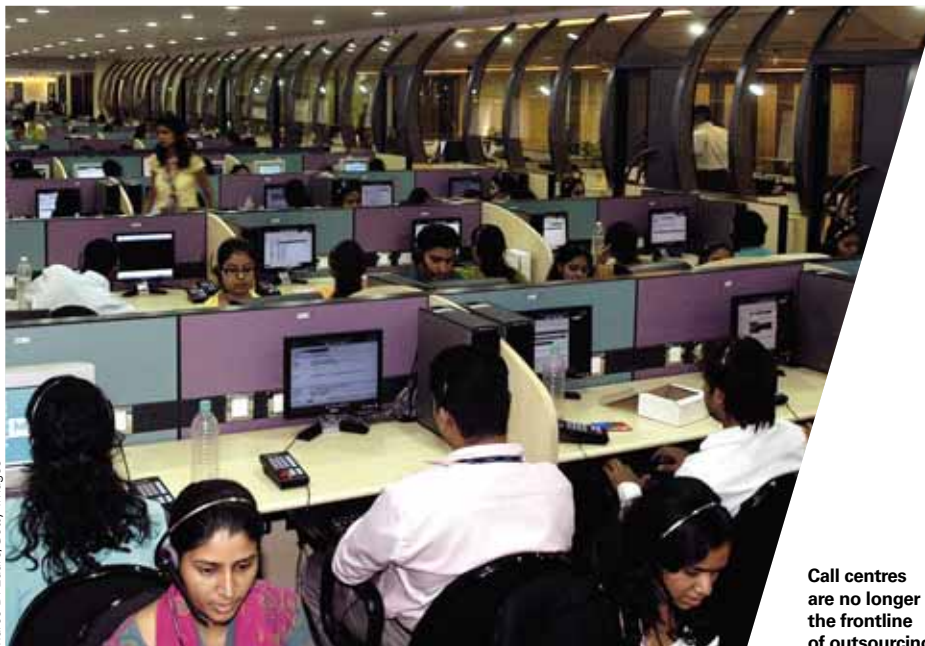
Mol Businesses shouldn't be afraid to present outsourcing as experimentation. When they outsource, they bring out the usual rhetoric about a strategic decision that allows them to focus on their core competences. It would be better to be honest: you are going to try outsourcing certain functions, and if parts work you'll increase them, and if parts don't you'll cut them. That would help develop a memory for future outsourcing efforts.

Few companies operate a management reporting system for outsourcing, to record experiences across functions. Individuals who make decisions about outsourcing tend to be guided mainly by their previous experiences – it would be better to look around the company, and other companies too, and draw on similar decisions.

Is there anything a company should not outsource?

Lepeak They need to work out what differentiates them from the competition – that's what they shouldn't outsource. Any customer touchpoint is sensitive, but there's no taboo about it anymore. Somebody somewhere has outsourced just about every function: high-end manufacturers are no more than design and marketing operations. Pharmaceutical companies don't do their own sales. The decisive factor may be your tolerance for the risk involved.

Mol The one thing you should never outsource is management of outsourcing itself. You need to keep the management of your suppliers inside the company. █



Call centres are no longer the frontline of outsourcing

Marco Di Lauro/Getty Images



The Aral Sea, expected to dry up completely by 2020, is vivid proof of the dangers of ignoring water as a resource

Kelly Cheng/Getty Images

water. In some places, 45% of water that's already been processed and treated is leaked out through pipes. If IBM had a business model where 45% of our product was wasted, we wouldn't be around long."

Water hasn't attracted the kind of scaremongering headlines that carbon emissions have, but its effect on growth is more immediate, and dramatic. Lack of water has hit power generation in Australia, California and India. In the Caucasus, the Aral Sea, once one of the world's four largest lakes, has nearly vanished. Middle Eastern countries – many of which are listed as "water-stressed" – have spent billions to add 100,000 cubic liters per day of desalinated water to supplies by 2015.

Such dramatic action may not be enough. The Pacific Institute think tank predicts global demand for water will rise 40% in the next decade. Industry accounts for 22% of global water use, behind agriculture at 70%. Sullivan says the impact is already being felt: "One major reason new power plants can't get sites is that they can't get water permits. It will increasingly be the driving factor in where businesses locate." Companies can't act alone, Sullivan says: they must engage with stakeholders including local authorities and NGOs.

Yet KPMG's 2010 Water Accounting Survey of 105 large multinationals found that 81% of retailers and 44% of manufacturers set no targets for water use. Only a handful actively audit supply chains.

Some companies are acting. Coca-Cola plans to be water-neutral in its bottling operations by 2012. Consumer goods giant Kimberly-Clark has conducted a global water risk assessment, including suppliers, to devise a coherent strategy. Others have spotted an opportunity: General Electric now has 50 desalination plants and a water services division with annual revenues of US\$2.5bn (€1.8bn). IBM is pioneering geo-analytic software to help utilities and local authorities improve water efficiency

Water seems comfortably abundant, but if businesses don't act it could become as volatile and expensive a cost as oil. ■

Managing liquid assets

Efficient water use has saved IBM millions. As this precious resource gets scarcer, others must take note

Your cup of coffee has a hidden environmental cost. It takes about 35 gallons of water to produce one latté. Ignorance about water use is expensive and dangerous. Controlling this resource is now a mission-critical issue for multinationals.

IBM's massive semiconductor factory is at the forefront of attempts to solve the crisis. The plant in Vermont, USA supplies memory components for the company's powerful processors. Nestled on the shores of Lake Champlain, a 490-square-mile expanse straddling the US-Canadian border, water should be the least of the site's problems.

In 2001, IBM began producing computer chips in Vermont for the commercial market, competing head to head with Asian manufacturers. The factory was using 3.2 million gallons of water a day, enough to supply a medium-sized city. "The plant was the biggest water user in the area," says Michael Sullivan, IBM's Global Lead for Smarter Water. "And you need very high quality water to create semiconductors." More than half the plant's water must be ultra-pure (10 million times cleaner than tap water), necessitating a tortuous filtration process.

IBM has stopped taking water for granted. A global water strategy has reduced usage by 2.8% a year since 2005. In Vermont, the company employed a sensor-based monitoring system to track water use and temperature across the plant. Engineers designed smarter working practices. Water is now warmed for purification using heat generated by manufacturing processes rather than electricity. The result is a 30% drop in water consumption over the past decade and an annual US\$3m (€2.18m) reduction in energy bills, even though production is 30% up.

"We pushed down water use so much the utility had to raise its rates," says Sullivan. "People need to understand the true value of

"In places, 45% of water leaks out. A business model where 45% of product was wasted wouldn't last"

What you don't know about... transformation

The unexamined business isn't worth leading, as Socrates might have said. So here are ten ideas to help you rethink the way your company operates and ramp up your performance



Transform yourself: you need to adapt to win business battles – and fast



The boss's indecision is final

A good decision made too late is the wrong decision. Corporate democracy – and a fashionable focus on the detailed mechanics of effective decision-making – have led too many companies to dither when they should act.

Business intelligence gives organizations information more quickly, but people are key to acting on it. When Stephen Elop took over as CEO of phone manufacturer Nokia in September 2010, senior colleagues joked that Chinese rivals could produce a new handset in the time it took the Finnish company to polish another internal PowerPoint presentation. Honda and Toyota have both slashed the size of their boards in the past year to accelerate decision-making.

Moving faster means putting power, and information, in the right hands. Alan Mullally, the Ford CEO credited with one of the most spectacular business transformations of recent times, began by asking senior managers to code their major projects on a traffic-light system,

according to their progress. The result was an end to lengthy meetings: instead, he had an instant dashboard giving early warnings of future road-blocks.

Leaner organizations can help, but a system for making decisions that is clearly understood at every level is even more useful. This should promote and reward collaboration and information-sharing, removing the need for complex approval processes that might span multiple time zones.

Julian Birkinshaw, Professor of Strategic and International Management at London Business School and a keen student of entrepreneurship in multinationals, says the most crucial question for larger companies is: "How can we combine being large and powerful with being responsive and flexible?"

The point isn't to rush decisions. But inside an organization the case for caution can often seem compelling, whereas the opportunity costs of failing to achieve a competitive edge can be hard to quantify.

Corey Hochstetler/Design Pics/Corbis

2

Millions of customers can't be wrong

In 1908, hotel magnate César Ritz ran an advert that said: *Le client n'a jamais tort* ("the customer is never wrong"). In hotels, the quality of customer service is a decisive competitive advantage and Ritz took his slogan seriously. Many companies pay only lip service to the idea – but that is changing. More than 400 major companies now have a Chief Customer Officer (CCO).

The new role reflects seismic shifts in the relationship between customer and company. Many businesses were slow to realize that just making good products was not enough and that they were as likely to be judged on, for example, the helpfulness of their switchboard staff. Before the internet existed, a disgruntled customer could tell a few friends; now they can share their grievance with millions.

Company culture often insulates leaders from the marketplace: one of the recurring motifs in the TV series *Undercover Boss* is the scene where the CEO recognizes how little they know about their customers.

Such ignorance is dangerous. That's why Bank of America, Boeing, Oracle, United Airlines and Walgreens are among the big brands to have appointed CCOs.

Roei Ganzarski, CCO at Boeing Training & Flight Services, said the breakthrough point for his company was the realization that "our operations team were focused on products, our finance team on billing, but nobody was looking at things from the customer perspective." After appraising the company's organizational culture, managers recognized they often made it hard for customers to work with them. "That's when we decided to create the role and realign our market-facing groups under it."

If CCOs are to succeed, they need to be on the board or have support from it. As one CCO at a software company noted: "Many companies will hire a CCO because they think they need one. In three years, we could see lots of flame-out because they weren't given the seniority or authority to make a difference."

3

Rethink finance – and be rewarded

"Anyone with any knowledge will have to acquire new knowledge every four or five years or else become obsolete," Peter Drucker once said. This is particularly true for today's CFOs.

In recession, many companies' finance functions crunched numbers or drove cost-cutting. With growth back on the agenda, they can become integral to operations. Transforming finance requires commitment, but the 2010 IBM Global CFO Study found the 'time to value' for such programs has come down dramatically, from 15 years to five or seven years.

True transformation takes in everything from more accurate forecasting and improved payment processes to better alignment with strategy and a clearer oversight of financial risk. Other measures on a checklist for the 21st-century CFO include crusading against complexity, simplifying budgeting and cutting measurement to using only six or seven measures at any level.

The rewards are significant: a 2009 KPMG International survey found that 60% of companies that had reorganized the finance function reported better overall performance.

Jochen Pampel, Global Head of Financial Management for KPMG and a partner in the German firm, believes that the most effective transformations tighten processes and optimize costs within finance, but leave companies with enough slack to react to ad hoc issues. So instead of decentralizing all key processes to local markets, a hybrid approach might leave a smaller number of key staff at head office with oversight of operations.

54%

of finance executives say processes for planning, budgeting and forecasting are the toughest to improve

Source: KPMG International



David Levenson

4

The truth about vision

Credit Steve Jobs. Apple's leader was so successful that, for many, he embodied the "visionary CEO." And that is why so many CEOs are now being berated, as US president George Bush Sr once was, for lacking "the vision thing."

So what is vision? The very word has mystical, even religious overtones, but for a CEO it can be as simple as knowing where you want your business to be – and communicating that effectively to every stakeholder. The Japanese management thinker Shoji Shiba says a visionary leader should view their company as an outsider does, possibly by on-site observation, so they can track the changes in society which will compel them to transform the business.

Bart Becht (above), the recently retired Dutch CEO of global cleaning products group Reckitt Benckiser, regularly walked supermarket aisles to understand what people were buying. He would even go into customers' homes to discuss how they cleaned. His vision, though transformational, was very specific: "We focused disproportionately on categories where we have strong leadership positions and can have good margins."

In Becht's case, this meant investing in dishwasher tablets ("penetration is growing every year and will do for years to come") and pulling out of shoe polish ("women don't polish shoes any more: they just throw them away"). By 2007, 40% of revenue was generated by products that had been launched in the last three years.

Becht was objective enough to make the tough calls to back some markets and abandon others. In this way, he was living up to the dictum of another visionary CEO, Amazon's Jeff Bezos: "We are stubborn on vision, but flexible about the details."

Ten issues

5

A matter of recency

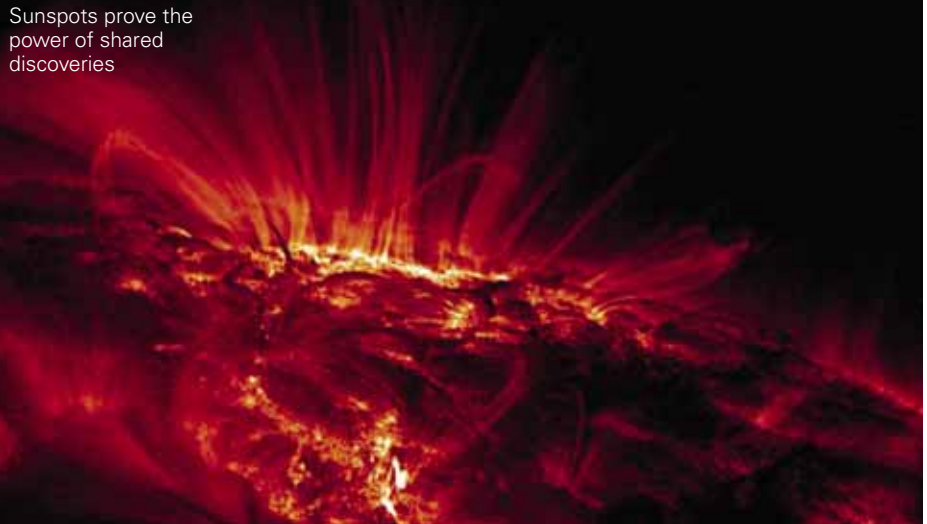
The idea that managers can have trouble distinguishing between the most urgent and the most recent events sounds absurd. But as far back as 1996, a study found that some auditors were influenced by the order in which they received evidence.

The recency bias is caused by the way human memory works – we remember the last items we dealt with better than the first – and could fatally distort the decision-making process. An emphasis on innovation has exacerbated this tendency.

William Shiebler, a retired CEO with years of experience in the US financial sector, says he tried to counter recency bias by studying economic history. “You have to be blind not to look at history. We have a better world because of the truth of it.”

History is certainly full of successful leaders who lost focus. For every Virgin, which has successfully diversified from music to travel, there is a Pitney Bowes. In the 1960s, the group forecast that postage would be a declining market and diversified into six areas including mortgage servicing and retail supply chain systems. But under Michael Critelli (CEO from 1997 to 2007), the group refocused on the postal market and grew its annual revenue by 50% to US\$5.7bn (€4.1bn).

Critelli, a fan of former Intel CEO Andy Grove’s book *Only The Paranoid Survive*, concluded: “If you rely on straightforward extrapolation from what has happened you will miss the signs of change – hence the need to be paranoid.”



Sunspots prove the power of shared discoveries

6

The sunspot effect

The mythology of science has conditioned us to believe in the transformational power of a lone genius. From Archimedes shouting “Eureka!” in his bathtub (which historians now doubt ever happened) to the apple that struck Newton, these tales persuade us that this is how innovations happen.

Yet Steven Johnson, author of *Where Good Ideas Come From*, says companies who really want to become more innovative should stop looking to hire the next Archimedes and build collaboration. Johnson suggests that innovations owe a lot to a theory he calls “the adjacent possible,” or as he puts it: “The history of cultural progress is almost without

exception a story of one door leading to another.” So, to take just one example, YouTube seems like an idea whose time has come. Launched 15 years ago, when there was no broadband and video cameras cost the earth, the internet video giant would have bombed.

If one door leads to another, Johnson says, it is far more likely that innovations are the fruits of teamwork and can happen at different places at the same time. Sunspots were discovered by four scientists in four countries in 1611. Steam engines and telephones were shared discoveries too. Johnson advises that the best way to innovate is for companies to expose themselves to serendipity, argument and conversation. This may, he says, explain the extraordinary creativity of Europe’s 17th-century coffee houses. Good ideas are networks which means, Johnson says, “chance favors the connected mind”



The WaltonsTV still by Everett Collection/Rex Features

7

Think like a family

The idea that senior executives should think of themselves as close relations might seem unbearingly sentimental. Yet families are most functional when they do something that leadership teams find increasingly difficult: spend time together.

General Electric realized this years ago, and built a guest house at its global research HQ in Niskayuna, New York for visiting staff, rather than stick them in a hotel. Noel Tichy, Professor at the University of Michigan Business School and a former GE executive, says: “It has turned out to be an incredible

relationship-builder between the R&D staff and the businesses, for the managers to have dinner and drinks with the scientists.”

Indian businesses – many of which are family-owned – have long understood these values. The TVS Group conglomerate offers everything from support in finding schools to retirement planning. The result? Employees have not walked out in a century, even during national strikes and revenue has hit US\$5bn (€3.4bn).

But families bring their own problems – simmering resentment, miscommunication and sibling rivalry. INSEAD Professor Randel Carlock, who has advised many family businesses, says the key is to become “professionally emotional” – acknowledging people are different, have their own motivations, and accepting their flaws.

8



“Imitation is not a dirty word”

by Oded Shenkar, Fisher College of Business

For Chinese companies, imitation is the sincerest form of flattery. So why are their Western counterparts so in thrall to the cult of innovation?

Open any newspaper, or take any class in business school, and you'll be inundated with the virtues of innovation. In the West, a path of constant reinvention is seen as the only route to business success.

This orthodoxy has rarely been questioned. Yet I believe the companies that succeed in the future will be able to imitate as well as innovate. Over time, imitation will cease to be a dirty word and will be seen as a viable means of growth.

In science and popular culture, imitation is seen as a necessary, sometimes noble pursuit. Business takes a different view, because it defines imitation as taking a rival product and incrementally improving it. In truth, it is wider than that and can include stripping down a product, or finding ways to make it cheaper for new markets. Chinese high-speed trains may conquer the world, yet owe much to Japanese, French and German design. The Chinese are not afraid to call this “re-innovation.”

This mindset does not apply only to design. Many believe business models cannot be copied, but I point to Southwest Airlines, which has always claimed to be so intricate in its structure that it is immune to imitation. Europe's Ryanair cheerfully admits it has imitated Southwest and – for all the PR problems it has endured – has taken its no-frills model even further and succeeded financially by stripping out all unnecessary cost.

The threat of imitation should not be underestimated. When US business leaders tell me how innovative the country is, I ask them to show me how they get paid for it. I rarely get a satisfactory answer.

CEOs in market-leading companies need a rear-view mirror. Most do not see imitation for what it is – as significant a risk as any financial factor. Meanwhile, they should re-examine their approach to innovation to focus not just on the next big breakthrough but also on replicating what works.

Oded Shenkar is professor of global business management at Ohio State University and author of *Copycats: How Smart Companies Use Imitation to Gain a Strategic Edge*.

SSPL/Getty Images, Ruben Kincaid/Alamy

9

Rewiring the future

CEOs may have given up on the idea that technology can be truly transformative. While the internet changed every business model, more targeted evolutions often under-delivered. But cynics might be surprised by new developments, says Bryan Cruickshank, Global Head of IT Advisory at KPMG and a partner in the UK firm.

Cruickshank points to data mediation technology (which lets managers draw targeted information from raw data) as a valuable tool, as well as the opportunity to migrate key business systems such as ERP to the cloud, an area nimbler SMEs have been quicker to exploit than multinationals.

Process improvements, he says, are the key difference. “In the past, the business case that got made for transformation was put on the shelf once it was underway and never revisited. As the project got mired in complexity and detail, going live became the be-all and end-all.” Canny leaders regularly realign transformation to business objectives, invest in robust program management and look for staged value that delivers incremental improvements rather than vast projects that take years to deliver.

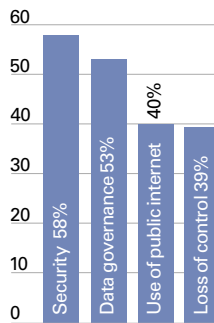
Cloud computing is driving many of the changes. But CEOs remain a stumbling block: a Symantec study found that while CIOs are overwhelmingly favorable about migration to the cloud, 53% of those in the top job are ‘somewhat less than open’.

“It used to be dangerous to be an early adopter,” says Cruickshank. “Now, the danger is in being a late adopter.”

Cloud concerns

CIOs' biggest barriers to greater cloud adoption

Source: Ovum/Cable & Wireless



10

Don't analyze this

When it comes to data, most companies want two contradictory things: they want it to be perfect and they want it now. Yet six out of ten companies in a 2010 survey by the Massachusetts Institute of Technology said they had more data than they knew what to do with. And even the basic data – head count, number of customers – isn't always consistent.

Sid Probst, CTO of the US enterprise software company Attivio, says the best way to live with such confusion is for managers to rethink their attitude to data. They need to learn that having a range of information is better than having one piece of information and that the accuracy of data is not an end in itself.

“Should you be so concerned with comparing apples with apples?” asks Probst. “Maybe the better question is: what's the result? If my analytic ignores 10% of my customer data but increases my conversion rate by an extra 2%, should I focus on fixing the problem so I include



that extra 10% of customer data, or should I just try to get an extra 2%?”

The other problem traditional data management faces today is that the amount of unstructured data – emails, documents, web pages, Googling – far exceeds the amount of structured data.

Too much data isn't just a curse for big corporations. Many golfers have succumbed to a kind of ‘paralysis by analysis’ as they try to improve their game. Graeme McDowell, who won the US Open in 2010, says: “I want to know why I hit a bad shot and that's all. I don't crave the knowledge of technique because I don't want to analyze every shot I hit.”

Could you be the biggest risk to your business?



AP/Press Association



Risk management is too important a function to be left in the hands of risk managers. Which is why the most successful companies are making sure it becomes everyone's business

H

ere is a story to make any CFO shudder. The treasury department of a major automotive company, noticing that platinum prices were forecast to rise, tied one of its major suppliers to a long-term, high-volume, fixed-price contract. Finance managers congratulated themselves on a deal well done, not knowing that, at that very moment, their R&D department was developing a new method of making cars that used a lot less platinum. The end result? A senior finance manager, who had done the sensible thing – on the basis of the information he possessed – paid for this organizational dysfunction with an unwanted early retirement.

John Farrell, a Global Advisory Partner for KPMG in the US who is an expert in risk and compliance, says this story illustrates why the management of risk is too serious and complex to be handled entirely by a chief risk officer. "Organizations need to realize there are two aspects to risk: control and content. Controlling risk might be a task for a select few in the risk function, but every employee is responsible for the content of a risk and should be able to articulate what they see as a growing risk, confident that their assessment of pending danger will be fed into a process which monitors concerns."

Gunter Dufey, Professor of Finance at the Michigan Ross School of Business, identifies five major types of risk which can impact companies: strategic (the risk that plans will fail), financial (controls might fail), operational (human error), commercial (the risk of business interruption) and technical (the risk of assets failing or being damaged).

This categorization is helpfully reassuring, but the insurance giant Swiss Re's list of significant risks – which includes everything from a warning that skin cancer from sunburn could cost the construction industry billions in damages to the observation that one in three countries has absolutely no plan to deal with bird flu – is an unsettling reminder of just how many variables are involved. Risks are magnifying and multiplying. In the UK, many companies are struggling to understand how the new Bribery Act will affect their business, especially in developing markets. Systemic risk – be it another economic meltdown or a global pandemic – can keep scenario forecasters fully occupied for the rest of their working lives. There are so many variables that any business's attempt to assess, manage and control risk might seem doomed.

Dufey says: "There's an old saying in the risk business that the only perfect hedge is in a Japanese garden. Companies now must deal with risks – for which we have historical information which we can use to measure their impact – and uncertainties, for which there is no known historical precedent so we have no way of knowing how they will impact us. If an airline hedges against the price of fuel, that is a risk. What is happening in the Middle East right now is an uncertainty."

CFOs and CEOs can't do much about uncertainties, but they can help their companies manage risk more effectively. "Every entity exists to create value for its stakeholders," says Dufey. ▶

The big issue

“Value is created, preserved or eroded by management decisions in every aspect of a company’s activity: from setting strategy to operating the enterprise. And all important decisions are fraught with risk.” Without risk, there is no profit. So the goal isn’t to minimize the risks a company takes, but to choose the level of risk that will best maximize shareholder value.

Defining that level of risk is crucial – but so is ensuring the company doesn’t take on more or less risk than is necessary. That is why many companies have risk councils and why practitioners frequently emphasize the importance of consultation, reliable business information, early warning mechanisms, changing employee behavior and the creation and application of fundamental controls.

Since the economic crisis, many companies desperate to identify the next big emerging risk have spent much unproductive time and money, Farrell says, looking for “a magic solution which will home in on the gravest danger and eliminate it with a minimum of fuss.” There is no such thing. Companies need to realize that identifying risk isn’t just about looking around corners or scanning horizons. “Emerging risks do not appear as something an eagle-eyed observer with a telescope might spot,” says Farrell. “They frequently arise from within – as a direct consequence of management actions.”

Ironically, given that the economic crisis was triggered by a colossal failure of risk management in certain parts of the finance industry, one risk many CFOs felt obliged to take to ride

out the ensuing storm was to downsize their risk management function. The folly of the “do more for less” approach to risk management was graphically illustrated by the Fukushima disaster, which left many companies realizing how poorly they understood the risks to their suppliers. One factory, which made one fifth of the world’s silicon wafers (a vital computer component), was only 40 miles away from Fukushima and had to shut temporarily.

Upsizing risk management departments is a straightforward task, but the factors which can change a company’s risk profile are complex, cultural and easily missed. Let’s start with an obvious one. Senior managers make a presentation to the board arguing for investment in a new pet project. So far, so straightforward. But Dufey says even this everyday ritual has hidden risks. “The people who run companies – and lead projects – are optimists. They have to be because if they weren’t, they wouldn’t be any good at their job. But because they are optimists, there is an in-built bias in favor of action. If a manager’s selling you a project, they’re not going to highlight everything that could go wrong.”

At this point, the culture of a company becomes critical. If managers are not encouraged to realistically appraise risk, it is left to the chief risk officer – or their boss – to act the killjoy and highlight the potential downsides. In such a situation, where risk is not thoroughly analyzed or represented by one voice, there is an inherent bias in favour of action. The official report by the court-appointed examiner into Lehman Brothers’ collapse found that the ailing investment bank made a deliberate decision to seek out risk – then ignored voices of reason as it “significantly and repeatedly exceeded its own internal risk limits and controls.”

Farrell says: “If you’re proposing to build a factory in Florida, you can easily calculate the risk that it will be hit by a tornado. But there are also many other less tangible risks. How robust is your supply chain? Could technology affect the demand for the product you’re manufacturing? What are the chances that construction might be delayed pending approval by the authorities? You need to be sure you have the thinking and the techniques in place to consider all the possible risk ramifications that could arise from such a decision.”






If companies don’t have such thinking and techniques in place, their risk profile could change without them realizing it. Dufey says: “I can understand why many companies want to appoint chief risk

Risk-loving Jordan Romero (center) became the youngest person to scale Everest, aged 13 – accompanied by his father



AP/Press Association

Five emerging risks you need to understand

Infrastructure	Environment	Regulation	Commodities	Innovation
 <p>A booming global population, urbanization and the need to be more competitive are pressing governments to invest in infrastructure. The OECD says the world needs a US\$60 trillion (€41.84trn) boost to infrastructure by 2030, but so far only 40% of that has been pledged. As supply chains now traverse the globe, this underspend could threaten sourcing networks.</p>	 <p>The risks of environmental damage are graphically illustrated on news bulletins. But headlines only tell part of the story. Green risks are many, varied and some don't even figure on the media radar – in the US, for example, many bee colonies are shrinking by 80%. This mysterious carnage will, if it continues, pose a threat to US\$15bn (€10.5bn) of crops that depend on bee pollination.</p>	 <p>Europe's bankers are fretting over a web of new regulations which, one study suggests, could wipe out 37% of their profits. Oil and mineral giants are nervous about sudden, expensive windfall taxes. Insurance companies in California are furious about new regulation of home and health insurance. Uncertainty over regulation – at state, national and global level – affects all.</p>	 <p>In June 2010, wheat cost US\$4.25 (€2.96) a bushel. Three months later, you couldn't have bought a bushel for less than US\$8 (€5.57). The spike caught out many farmers, who had sold their stocks on forward contracts when prices were low. Such volatility is in danger of becoming the norm. Extreme swings can be self-perpetuating, as suppliers and buyers try to second-guess the market.</p>	 <p>For many companies, innovation isn't a cultural value, it's a guarantor of profitability. But with R&D globalized and dispersed – many centers are based in emerging markets – there is a growing risk that innovations get lost in bureaucracy or don't achieve creative momentum. Companies may make the wrong cuts, and become, in innovation terms, one-hit wonders.</p>

officers, but the danger is that other managers abandon their responsibility for assessing risk." One of the difficulties is that many leaders fail to understand the ROI in risk management. "If risks are managed properly, the disaster never happens and managers don't even notice."

That ROI may not be as straightforward as investing in a new product or new plant, but it does exist. In an industry – and a market – as volatile as technology, Microsoft has cushioned itself against risk, keeping costs flexible by using more temporary workers than its rivals and maintaining a low leverage.

Some mismanagements of risk can prove fatal. Take the case of Hechinger, an American retailer of DIY products which relied on its suppliers for financing. In 1999, one default on an interest repayment prompted anxious suppliers to slash their credit, intensifying the firm's credit crunch so it couldn't adequately stock its own stores. As customers deserted, it went into liquidation.

The repercussions are not always that stark in the short term, but they can significantly affect long-term outcomes. Every change of strategy can alter a company's risk profile and that shift can, in turn, increase, protect or destroy value. And sometimes, Farrelly says, new risks can be created by the ripple effect as a dozen variables change throughout the business. If the controls, capabilities and

"Without the leadership knowing, mid-level managers may have authority over decisions that could put billions at risk"



culture of a company aren't right, these emerging risks can eventually pose a substantial threat.

With the swings of the business cycle becoming more extreme, the pace of change accelerating and the value of a company's reputation ever more fragile, mismanaged risks can do serious damage very quickly. That is one reason, Farrell says, why CEOs and CFOs need to take the lead. "You can't change your risk management culture if the impetus is coming from the risk management function alone. The company leadership must drive the change. But it is important for them to realize that senior and middle managers often influence behavior and set the tone. Many employees will take their attitude to risk from their immediate supervisor."

Making sure the message is consistent from top to bottom is especially important in large organizations. Farrell says: "Sometimes, without the leadership knowing, mid-level managers may have decision-making authority that could put millions or billions of dollars at risk."

The first decade of the 21st century has seen enough disasters – corporate, economic, environmental, financial and political – to show that risk management is far too important to be left to risk managers. Businesses can never eliminate risk, but they can improve the way they manage it and minimize the damage. That is a modern cultural and organizational challenge. But the most powerful lesson CEOs and CFOs should take from all this is that sometimes the biggest risk to a business can be themselves.

Trans World Airlines was one of the most innovative companies in the aviation industry. In its heyday, TWA seemed too big to fail. But Charles C. Tillinghast Jr, the TWA boss from 1961 to 1976, made two colossal misjudgements. His insistence that "there's no money in the Pacific and there's no money in cargo" was a strategic error that started this famous company's gradual decline – it filed for bankruptcy in 1992. With a risk management culture that encouraged staff to feed back their views of the risks of misreading the market, TWA might still be flying today. ■

Left field by Paul Simpson

The bottom line of comic timing

Saturday Night Live can teach business a thing or two about how to nurture innovation, when to let stars go – and why procrastination can be disastrous

Every company would like to be more creative, yet they rarely study companies in the creative sector.

You can buy books on what CEOs can learn from IBM, Harvard Business School and Attila the Hun, but there has been no tome called something like *Six Effective Habits of Comedians That Can Transform Your Bottom Line. Bossypants*, a new title by American comedian and writer Tina Fey, threatens to fill that gap. Kind of.

Famous for impersonating Republican politician Sarah Palin, Fey's big breakthrough came on *Saturday Night Live (SNL)*, the enduring US comedy sketch show. Her insight into that show contains plenty of relevant truths for business leaders.

SNL may be in a creative business but the show is governed by a discipline which gives it an edge few companies in other industries can hope to replicate: the team know when their product has to be released. The show doesn't go on because it's ready, it goes on because it's 11.30pm. In other words, Fey says, do your best and let go at the last possible second.

A marketing window that shuts before a product is launched can prove disastrous, but because opportunity cost is notoriously hard to estimate, many companies delay and pay the price. The ultimate proof that the perfect is the enemy of the good is the computer game *Battlecruiser 3000AD*, marketed in 1992 as the "last thing you'll ever desire" in computer games but not released until 1996 on what was, by then, the obsolete DOS operating system.

The creation of *SNL* is a collaborative process which many businesses could learn from. Scripts are read out and debated around the table by writers, directors and producers – though the producer ultimately says what makes the cut.

The programme institutionalised 'flat management' long before the idea became a cliché and the approach is similar to the flat, lattice-style, organizational structure which has helped W.L. Gore, the fluoropolymer giant, feature so regularly on

Fortune's annual list of the 100 best companies to work for in America.

Comedy may be a creative business, but creativity isn't given free rein. If actors try to be 'creative' – often code for embellishing their role – they are usually ignored. Yet Fey does advise: "Never tell a crazy person

"Never tell a crazy person they're crazy. These people occasionally turn out the best stuff"

they're crazy... the most exhausting people occasionally turn out the best stuff". Creativity isn't a god to be worshipped, it's a challenge to be managed.

SNL's staff – which Fey divides into "Harvard nerds and Chicago improvisers" – sharpen the script round the table but the show has long had a strong ad-libbed element. One principle of improvised comedy, Fey says, is that "Yes and..." is better than "Yes but..." if you want to build creative momentum – a lesson many companies ignore and wonder why brainstorming sessions prove so lackluster.

The war for talent never ends and on that criterion alone *SNL* is a success, breaking the likes of John Belushi, Bill Murray, Eddie Murphy and Dennis Miller. While many businesses strive to keep their stars, *SNL* assumes there's always a new one on the horizon. This approach isn't unique to TV. Ferran Adrià, the Spanish chef behind some of the world's most feted restaurants, says: "When you're here, you get to dream and be passionate. But it's very intensive: 90% of staff change each year."

Such radicalism shouldn't be dismissed. Most geniuses have a short shelf life. Sir Isaac Newton's finest discoveries all came between 1664 and 1666 and his failure to repeat such insights fuelled his depression. The careers of many *SNL* alumni have proved almost as meteoric – a fate Fey will hope to avoid. ■



Tina Fey has benefited from *SNL's* flat management structure and ruthless approach to creativity

AOB



Need to know...

Complexity

What is it?

The word has its roots in *complexus* (Latin for 'plaited') but also refers in chemistry to something with a number of parts or in maths to a combination of compounds. In modern business parlance, it refers to the sense that organizations risk being overwhelmed by the complicated nature of the world they operate in.

What does it mean for businesses?

Every leader faces the same simple problem: they don't know what they don't know. We are hard-wired to believe we know more than we do and to cherish unrealistic views of our abilities (author Nassim Nicholas Taleb famously quotes a survey which found that 94% of Swedes believed they were in the top 50% of Swedish drivers). Success encourages such tendencies, partly by insulating us against many of the realities that could force us to question what we think we know.

Power may not corrupt in the clichéd sense, but it can degrade our decision-making. In a complex business world, such degradation can rapidly prove disastrous.

How do you cut through complexity?

Organizations need to draw on all kinds of data – not just the traditional structured kind but emails, media stories, conversations

with customers – to shape their strategy. And question their model of management.

"When Einstein developed the theory of relativity, he showed that physics was much more complex than the Newtonian simplicities of apples falling on heads had led us to believe," says Alan Buckle, KPMG's Global Head of Advisory. "The task of managing a global organization has gone through a similar, revolutionary leap in complexity but many companies are still managed – and develop their strategies and business models – as if the old certainties still apply." Leadership can no longer be one-directional. A more interactive approach might seem inconveniently complex but could deliver significantly better outcomes.

In 2009, Michael Jarrett of London Business School studied 250 companies to identify why some managed change successfully. He found the crucial factor was "readiness to change". Companies that were internally predisposed to change were good, Jarrett found, at scanning the horizon and making sense of new trends and data to influence their strategy.

Scanning the horizon sounds like a job in itself...

Many CEOs allocate some of their time – 15% is not untypical – to this task. Buckle says: "There is no substitute for personal knowledge. An objective CEO will want to sound out people they know outside their business – and may also want to seek disinterested, professional advice as they develop and challenge their strategies."

Isn't there a risk of getting bogged down in all this knowledge?

Buckle says: "One secret of success in business is knowing when to take advice and when to ignore it. Letting advisers, or the data, effectively make your decision is an abnegation of leadership." CEOs need to ensure their teams spot the piece of data, or trend, that makes profitable sense of a complex world. Sometimes, such 'data' can be simple and close to home. Ruth Handler invented the Barbie doll in 1959 after seeing her daughter play with a paper doll and thinking how much more fun the girl would have with a 3-D plastic doll. A billion units later, Handler has been proved triumphantly right.

Contact us

If you want to tell us what you think about *Agenda* or request another copy of this publication, please email us at:

agenda@kpmg.com

To find out more insights into growth, performance and governance, please visit the *Agenda* website at kpmg.com/agendaonline

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation. © 2011 KPMG International Cooperative ("KPMG International"), a Swiss entity. Member firms of the KPMG network of independent member firms affiliated with KPMG International. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International.

Publication name *Agenda*: insights into growth, performance and governance Published by Haymarket Network Ltd Publication no 314811 Publication date November/December 2011 Printed in the UK by Pureprint using their pureprint® environmental technology. Vegetable-based inks were used throughout. Pureprint is a CarbonNeutral® company accredited with Environmental Management System, ISO 14001 and registered to EMAS, the Eco Management and Audit Scheme.