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# Management

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**Expanding the CMA toolbox: Using The Variance Tree to make superior price/volume trade-off decisions**

**Risk and performance management through the business cycle**

Matthew Scott, CMA, director of operations and strategic development, ZTR Control Systems and TR Electronic

## Overcoming trying times

Matthew Scott, CMA, shows the value of remaining optimistic during economic challenges.



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# Motivation in the workplace

Employees are vital to the success of any organization. What are organizations doing to recognize the invaluable contribution their employees make on a regular basis? Although employee satisfaction should be an important goal for any organization, a survey by The Conference Board suggests that job satisfaction has actually declined in the last nine years. When we think of the factors that usually keep employees happy, salary, benefits, and monetary perks often come to mind. Although these items may help keep the satisfied employee motivated or feel appreciated, what about the disgruntled worker? Can money really buy happiness? While working with small to medium-sized organizations for over 12 years, Deborah Archambeault, Christopher M. Burgess and Stan Davis suggest that although most employers often focus on monetary solutions, they often overlook low cost or no cost opportunities to increase employee satisfaction. In their article "Is something missing from your company's satisfaction package?" they offer some suggestions that organizations can implement to increase overall employee satisfaction.

There's been a lot of coverage about the tasks of leaders and the skills required to maintain a strong leadership in the workforce, but what about maintaining that leadership during economic challenges? In Anita Caputo's article "Dealing with the aftershocks," Caputo discusses the importance and need for leaders to motivate their employees in the aftermath of the credit crisis.

She mentions how extraordinary leaders have walked in and out of her life; however, "the most memorable leaders are those who touched my heart and helped me grow." I'm sure if we stop and pause for a moment, we can all think of at least one leader or mentor who's had a positive influence on our career choices, or someone who's supported a decision when others disagreed.

Whether leaders are born or made, they possess personal traits, moral qualities or charisma that we tend to look at, sometimes more than what they've actually accomplished. Leaders do not command excellence; they build excellence, during good and bad times.

CMA Canada and its provincial partners will be saying farewell to one of its leaders next month. Steve Vieweg was named president and CEO of CMA Canada in September 2003. Prior to joining the national office, Vieweg was the executive director of the Society of Management Accountants of Manitoba, a position he held since 1994. Along with his work with the national board of directors in setting the strategic direction for the organization, positioning the CMA brand, and increasing the value proposition for certified members, he has been a tremendous support to the magazine. We'd like to wish him success (and safe travels) in his future endeavours. He's a leader who will truly be missed.



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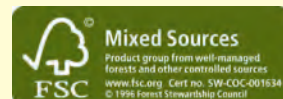
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# CMA Management

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The Variance Tree aims to break business performance into its fundamental driving elements. It is similar to budget variance analysis — performing comparisons (calculating variances) and splitting the performance metrics into sub-elements. However, the difference lies in two key areas.

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Conventional wisdom suggests that, salary, benefits, and other monetary factors are important aspects of keeping employees satisfied. But which factors have the biggest impact on overall satisfaction? While companies focus on the monetary factors, there are other components of the overall "satisfaction package," that are just as important, yet often overlooked.

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Even when the dust settles, economic downturns will not be a thing of the past. Business cycles—which entail ups and downs by their very definition—are here to stay. If companies are willing to accept that, the key question becomes: How can organizations adopt reliable risk management "through the business cycle" to deliver sustainable performance?

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# Growth strategies

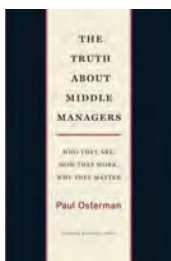
## Cats: The Nine Lives of Innovation



Most successful business people will tell you that curiosity is the key to innovation. *Cats: The Nine Lives of Innovation* is a playful and upbeat book that includes information and anecdotes that can be used to spark curiosity and creativity. Author Stephen C. Lundin suggests that too much attention has been devoted to top executives and an organization's strategy, and far too little attention has been paid to the primary source of innovation — individual employees. He uses the term “CATS” to describe people who practise the “nine lives” of innovation. The “nine lives of innovation” include: Life 1: CATS create an innovation-friendly environment, Life 2: CATS are always prepared, Life 3: CATS know that innovation isn't normal, Life 4: CATS welcome physical provocation, Life 5: CATS enjoy social provocation, Life 6: CATS promote intellectual provocation, Life 7: CATS say “how fascinating,” Life 8: CATS fail early and fail well and Life 9: CAT wranglers understand natural energy.

By Stephen C. Lundin, Ph.D. McGraw Hill.

## The Truth about Middle Managers



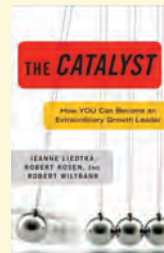
Middle management is often at the centre of restructuring. They are often seen as wasteful overhead or an unnecessary layer between the line workers and senior management. How much of this is truth versus perception? The answer may surprise you. In *The Truth about Middle Managers*, author Paul Osterman has analyzed over 30 years' worth of employment data and

interviewed a variety of managers to uncover a different picture of today's middle managers. Not only have their numbers increased dramatically, but middle managers are wealthier, more productive, and more autonomous. Osterman presents a few common myths about middle managers and reveals the truth using actual facts and data. “Both

organizations and social scientists need to revise their view of middle managers,” Osterman says. “Middle management has oscillated between being invisible and being a target. Both perspectives are wrong. Middle managers should be valued for what they contribute and should be seen as a resource to be developed. Such a perspective is more accurate and healthier and would be more productive for all concerned.”

Paul Osterman. Harvard Business Press.

## The Catalyst



Dormant growth exists in every company — all it needs is a manager with a catalyst mindset to find it. In *The Catalyst: How you can Become an Extraordinary Growth Leader*, Jeanne Liedtka, Robert Rosen and Robert Wiltbank suggest that the secret to growth in any economy is managers tapping into existing resources to find

overlooked revenue. They address questions such as: What does it take to overcome such seemingly insurmountable roadblocks? How can you crack the code to discover and pursue new opportunities? How can smart organizations recruit growth leaders, train them, and learn from them instead of getting in their way?

In a study sponsored by the Batten Institute at the University of Virginia's Darden Graduate School of Business, the authors studied 50 “growth leaders” from some of North America's largest companies to answer these questions. The authors discovered that instead of placating risk-averse companies with reams of data that just keep them stuck in growth gridlock, extraordinary managers find growth from the assets and capabilities already at their disposal, manage affordable loss rather than return on investment, learn by doing and lead with pragmatic idealism.

Jeanne Liedtka, Robert Rosen and Robert Wiltbank. Crown Business.





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# News and views

New and noteworthy information you can use

## Corporate sustainability reporting remains an issue for Canadian companies

Reporting on the environment and social impacts is important to senior financial executives according to a survey from PricewaterhouseCoopers LLP (PwC) and the Canadian Financial Executives Research Foundation (CFERF), the research institute of FEI Canada.

*The Corporate Sustainability Reporting — Executive Research Report* comprises the results of a survey conducted of 343 senior financial executives across Canada as well as the insights of individuals who participated in an executive research forum. Just fewer than 50 per cent of the survey respondents represent enterprises with annual revenue of \$250 million or less, with the remainder being companies with revenues ranging from \$250 million to more than \$20 billion.

Almost all (92 per cent) senior finance executives felt that it was important to communicate sustainability performance to senior management and the Board, while at the same time, over half admitted that they did not have an effective system and process in place for periodically measuring sustainability performance. When asked if this same information should be periodically reported to shareholders, employees and external stakeholders, most agreed that this was important. However, over half (55 per cent) admitted that their companies did not have an effective system in place to enable this type of reporting. Indeed, most respondents (78 per cent) believe that the average investor does not have enough information about the sustainability performance of Canadian companies.

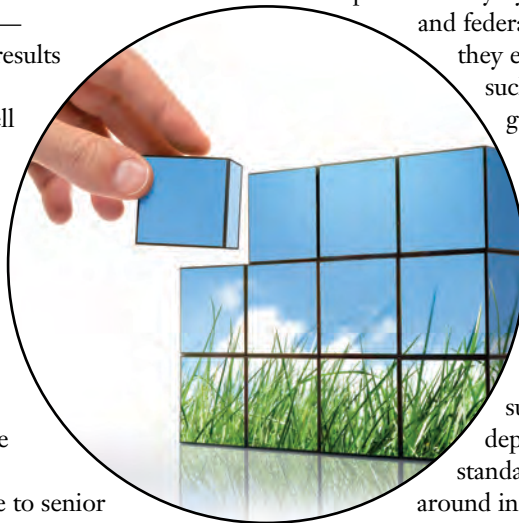
“Several forces may be working together to explain the disconnect,” says Mike Harris, PwC partner and leader of the firm’s sustainable business solutions practice in Canada. “First, a general framework does not exist for measuring and reporting, making comparisons between industries a challenge. Second, many companies have not developed robust data collection systems to make the reporting process efficient and reliable,” he says. “Third, most finance executives continue to only focus on the mandatory financial disclosures and finally, the cost/benefit of optional sustainability reporting does not provide support for the types of systems and process required to effectively implement it. Until sustainability reporting is mandatory, this is likely to

remain the norm.”

According to the survey, larger companies were more likely to link the application of corporate sustainability practices to business goals. When it comes to industry sectors, reporting practices vary by the extent to which each are locally and federally regulated and the extent to which they emit pollutants into the environment, such as oil and gas, or hydro-electric power generation.

The majority of financial executives polled believed that regulatory requirements pertaining to sustainability disclosure and reporting will increase in the years to come.

“For many senior financial executives participating in this study, the future development of corporate sustainability reporting in Canada depends on the establishment of a standardized reporting framework developed around industry-specific key performance indicators (KPIs),” says Ramona Dzinkowski, executive director of CFERF. “Ultimately, the CFO has, and will continue to have, a major role to play in driving the corporate sustainability agenda of Canadian corporations.”



### Management

#### Editorial Think Tank

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## Assistants influence the hiring decision

Hiring managers aren't the only ones applicants need to impress when they arrive for a job interview. Candidates should also be on their toes when greeting the boss's right-hand person, a new survey shows. Nearly seven out of 10 (69 per cent) executives polled said they consider their assistant's opinion important when evaluating potential new hires.

The survey, developed by OfficeTeam — a staffing service specializing in the placement of administrative professionals, includes responses from 100 senior executives across Canada.

"As soon as they enter the parking lot, job seekers should be on their best behaviour. Everyone they encounter, from the person in the elevator to the receptionist, is someone who could potentially weigh in on the hiring decision," Robert Hosking, executive director of OfficeTeam, says. "Just as treating the waiter rudely at a restaurant creates a bad impression, being discourteous or abrupt with a company's receptionist or office staff can reveal character, or lack of it, in job applicants."

Hosking adds, "Administrative professionals know their boss's management style and understand the work environment, which makes them adept at identifying people who are a good fit and is why executives value their opinions." OfficeTeam offers the following tips for making a positive impression before and after the job interview:

- Mind your phone etiquette. Be friendly and professional with the "gatekeeper" when phoning the hiring manager. He or she controls access to this person and could someday be your colleague. Also, learn the assistant's name and address him or her properly on calls during the interview process. This increases the likelihood that you'll be put through to the hiring manager.
- Make a memorable introduction. When checking in with the receptionist or assistant prior to an interview, start a light conversation if it appears he or she isn't too busy. Ask for materials or brochures about the company, or inquire about news you uncovered while researching the organization. The discussion could leave a positive lasting impression with the assistant and the information you learn might prove helpful when meeting with the hiring manager.
- Be engaged. After checking in, don't act as if you're the only person in the room. Avoid snacking, chewing gum, talking on your cell phone or listening to your headphones.



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# Dealing with the aftershocks

How are leaders motivating the “corporate survivors” in the aftermath of the credit crisis?

By Anita Caputo, CMA

All you have to do is read the daily headlines to know that the foundation of our economy has been significantly shaken and that the companies closest to the epicenter of this global financial crisis have been destroyed. Relief efforts continue in the form of bailout rescue plans for the companies struggling to survive the aftermath. One does not need to look too far for examples. At the time of writing this article, General Motors and CanWest Global are on the brink of bankruptcy, while Canada’s once darling company, Nortel, is in bankruptcy protection.

A news release issued by Nortel on Jan. 14, 2009, states: “The Company’s normal day-to-day operations are expected to continue without interruption.” Are these expectations realistic, considering the people who keep the operations running are ready to run away from the business?

**Managers/leaders must not be complacent about the people left behind to carry the company through in these uncertain times.**

Simply put, people make up companies. Without people, companies wouldn’t exist. Research tells us that at the heart of successful companies are satisfied customers created by satisfied employees. Reason tells us that the inverse is also true. At the heart of failing companies are dissatisfied customers created by dissatisfied employees.

In the face of our economic woes and unrelenting layoffs, I set out to gather information about “corporate survivors,” those employees who are viewed by some, and maybe even themselves, as the “lucky ones” — the ones who still have a job, the ones who have not yet been laid off. I wanted to know



what day-to-day life was like for them in their struggling companies. Grateful to have a job, are they motivated, satisfied employees?

What gets missed in all of the news headlines and in most boardrooms are the people — those who make up the company. Within any one of these companies, you’ll find real people with hopes and dreams, people with children, people with mortgages, loans and other financial commitments, people trying to make ends meet.

During my discussions with the employees, I expected to hear about their feelings of relief, sorrow, guilt, gratefulness and fear. To my surprise, what I heard was a critical assessment of their leaders.

The employees that I interviewed at the companies that were tinkering with bankruptcy were dispirited. They reported being frustrated, overworked and stressed. One employee passionately started our conversation with, “Where’s the humanity?” After speaking with other employees of the same company, interestingly, the number one issue that was mentioned was the lack of trust and confidence in the



leadership team. Senior management was reported as being incompetent and having a history of bad decisions. They were perceived as unethical and they were accused of taking actions which were self-serving as opposed to being focused on customer success and employee satisfaction. At one company, employees reported the level of stress, frustration and pent-up anger being so high that employees are concerned that someone will “snap” under the pressure and endanger the safety of others. At the core is the loss of trust and respect of the management team by the employees. The question becomes, “How should a leader lead in these uncertain times?”

### Leadership expectations

That got me thinking about leaders who have touched my life. I thought about memorable political and corporate leaders, my teachers, managers and even my parents. Those leaders have had a significant influence on who I am today. The most memorable leaders are those who touched my heart and helped me grow. Under their leadership, I was inspired, challenged, motivated and rewarded. I trusted and respected them, and in return, they earned my loyalty.

And then there were the leaders who significantly contributed to the stress in my life. Their self-centred and cunning ways served to diminish my spirit, my confidence and my belief in myself. Under their leadership, time could not pass quickly enough and I am forever grateful that they are not in my life today.

We look to our leaders for focus, inspiration and hope. We respect them for their competence, integrity and courage. We look to them to “walk their talk,” to

demonstrate confidence, and to behave in compassionate, ethical ways. Because we are loyal, we are forgiving when they make a mistake.

Managers/leaders must not be complacent about the people left behind to carry the company through in these uncertain times. Caring for employees has to be management’s number one priority. After all, it is the people who do the work and create value for the customers. It is the employees who create customer success, which in turn, creates profitability and business success.

### At the core is the loss of trust and respect of the management team by the employees. The question becomes, “How should a leader lead in these uncertain times?”

As a leader, you must show your employees empathy. You must acknowledge their feelings, even if it means just being a sounding board. You must also communicate in a way that tells them you understand the difficult circumstances they find themselves in. You must provide them with hope for the future, for it is that hope, combined with their confidence and faith in your ability to lead them back to prosperity that will energize and unite them to do what needs to be done to emerge from these tough times.

I will leave you with one of U.S. president Barack Obama’s inspiring quotes: “Change will not come if we wait for some other person or some other time. We are the ones we’ve been waiting for. We are the change that we seek.” Be courageous, dare to be different if you must. Make the time to be compassionate and to put your employees first. You and your business will be rewarded in more ways than you will ever know. ■

Anita Caputo, CMA, is a work change resilience expert, author, and founder of Big Picture Institute ([www.bigpictureinstitute.com](http://www.bigpictureinstitute.com)).

### Lead your team back to prosperity by “walking your talk” and living the following simple principles:

- 1) **Be authentic** — As a leader, you must genuinely care for the success of the customer and for the well-being and success of your employees. Your decisions and actions must be congruent with your communications (words, tone and body language).
- 2) **Customer and employee focused** — In order to have a strong correlation between satisfied employees and satisfied customers, you must engage your employees by making them feel good about themselves. People are intrinsically rewarded by challenging work and knowing that they have made a valuable contribution to the results achieved. Invite employees to contribute ideas and to be an active player in creating company success. Listen to what they have to say. Take their suggestions seriously.
- 3) **Goal oriented** — Be focused and be realistic about what can and should be done. Don’t try to do everything. Prioritize what needs to be done to prevent employees from feeling completely overwhelmed and demotivated.
- 4) **Give hope and inspiration** — U.S. president Barack Obama is a wonderful example of someone who is giving the people of America, and perhaps the world, hope and inspiration. It is this positive influence that fuels our energy when the chips are down.





# Need financing? Build your business credit profile

We may be hearing that the government is supporting lenders in order to provide businesses with the capital they need to survive this economic hurricane; however, what we are seeing, is not that rosy.

By Glenn Agro

The fact is that, Canada's Schedule A banks — the primary lenders to the country's small and mid-size businesses — have limited capital available and, for the most part, are deploying that capital to support current, rather than new customers. And even existing customers are finding that the cost of borrowing is rising and that their financial performance is also being monitored more frequently by the banks.

Still, despite these challenges, banks and other lenders will support companies with solid fundamentals and healthy practices. There are a number of things management teams can do to strengthen their corporate credit profile in order to maintain relationships with current lenders and to establish creditworthiness with new lenders.

## Secure current lending relationships

Securing existing lending relationships requires staying in close contact; bankers don't like surprises. It's absolutely vital to keep lenders informed about the health of the business. While no lender wants to fund losses, they do understand that healthy companies experience temporary periods of difficulty. They want to know what steps management is taking to address economic challenges. If extra support or capital is needed, it is critical that borrowers provide lenders with sufficient lead time to thoroughly assess the situation.

When renewing credit arrangements, it's important to prepare well ahead of agreement termination dates — review loans, leases and mortgages to assess whether they represent the most appropriate and affordable forms of financing for the company's needs during the coming months. What terms and conditions are



manageable? Do agreements allow a buffer to enable the company to manage through a temporary period of financial difficulty? Do covenants allow some flexibility in case revenues fall?

It's important to keep in mind that even though interest rates are at historic lows, new loan rates are not. The cost of capital is rising. Many of the banks are also introducing fees such as standby charges of one-quarter to one-half of a point for untapped lines of credit.

Lenders have also reduced the debt-to-equity threshold for transactions. Only a few months ago, a ratio above 3:1 was acceptable; now it's closer to 2:1. Moreover, banks are instituting more restrictive covenants to direct cash flow into debt repayment and are also requiring more security. They expect companies to meet forecasts and to link commitments to plans.

When meeting with a lender, be prepared to demonstrate that the management team has a solid action plan. Include conservative projections of what the next one to two years are expected to look like



under varying scenarios – a 15 per cent decrease in sales for example, as well as a 30 per cent drop. Projected financial statements should also have well-supported assumptions. Indicate the trigger points when the management team will make decisions. Outline what support may be needed and what contingencies are in place to repay the loan should problems arise. Show that management understands the issues and can make the necessary adjustments or cuts to operate within the bank's parameters.

### Arrange contingency borrowing

Having a backup financing plan is essential in the event the bank or other lender restricts borrowing capacity or decides not to renew the company's loan or line of credit. Begin the process of identifying alternative lenders several months ahead of agreement expiry dates, since it may take this long to establish a new relationship. As well, corporate customers have fewer lending options than only a few months ago. Most U.S. lenders have disappeared and every remaining lender is cautious about credit quality.

Investigate alternative sources of capital such as leasing companies, commercial finance companies, private equity investors and government-backed financing initiatives. The 2009 federal budget provided a hefty capital infusion to support Canada's businesses. The maximum eligible loan amount under the Canada Small Business Financing Program for any one business is now \$500,000, of which a maximum of \$350,000 can be used for purchasing or improving new or used equipment or leasehold improvements. The maximum of \$500,000 can be reached through the purchase of building and land. As well, the budget introduced enhanced loan and credit support by increasing the limits for authorized capital, borrowing and contingent liability of the Business Development Bank of Canada and Export Development Canada. While these options are still more expensive than financing provided by Schedule A banks, they now have broader mandates as well as more capital.

### Strengthen the balance sheet

To secure capital from any type of lender, a company must convey credible reassurance of repayment ability. Risk tolerance has declined along

with economic conditions. A company's current ratio, for example, needs to be at least 1.25:0 to demonstrate convincing capability of meeting debt obligations.

Generally, the first place lenders look to back their security is the balance sheet, thus it is vital to look at every possible way to strengthen it. Consider, for example, improving working capital position by consolidating debts. Are there opportunities to secure longer-term financing, extend loan repayment schedules or to eliminate loans by selling non-core assets or orchestrating a sale-leaseback of land, buildings or equipment?

It's also important to demonstrate that the company is managing costs. Regularly monitor the ratio of costs to revenue and eliminate expenses that do not contribute direct value to the organization. Don't make rash cuts, but do create a contingency plan that outlines how management intends to reduce the cost structure in the event this may be necessary. Be prepared to make a strong case for any new long-term commitments, such as expansion, hiring or new supply contracts. Lenders will support synergistic acquisitions that make sense, but will expect to see the combined balance sheet of the new entity support the financing of the transaction.

Reduce surplus inventory as much as possible. Where needed, monitor inventory turnover, track and measure lead times, review minimum order quantities and price quantity breaks and work with suppliers to improve delivery efficiency.

The quality of accounts receivable is also an important indicator for lenders. Review credit policies and collection procedures to reduce over-extended customers and eliminate any receivables lingering past 90 days. Consider accounts receivable insurance to provide lenders with additional reassurance.

Tracking the following ratios each month can help the management team monitor levels of profitability, liquidity and efficiency that lenders will assess.

- Sales actuals to projections.
- Gross profitability (gross profits/net sales).
- Net profitability (net income/net sales).
- Debt to equity (liabilities/shareholders' equity).
- Current assets to current liabilities.

When meeting with prospective lenders, a detailed business plan is essential – one that provides a realistic portrayal of the marketplace and the company's position. Goals and strategies should be straightforward, achievable and capable of generating value for the company in the short term. Lenders will expect more security, so be prepared to offer additional collateral, guarantees or insurance.

As long as the world's economies continue to struggle, lenders will continue to be concerned with credit quality. A strong credit profile will be the corporate ticket to capital, survival and success. ■

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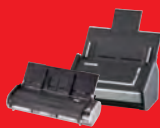
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# **Expanding the CMA toolbox: Using The Variance Tree to make superior price/volume trade-off decisions**

**The Variance Tree aims to break business performance into its fundamental driving elements. It is similar to budget variance analysis — performing comparisons (calculating variances) and splitting the performance metrics into sub-elements. However, the difference lies in two key areas.**



By Scott Miller, CMA and Jim Saunders

**M**anaging the price /volume trade-off is at the heart of a business unit's purpose. Fundamentally, there are two steps to assist with this process: gather and analyze the appropriate data and forecast the predicted outcomes under different sets of assumptions. However, we regularly find that businesses make pricing decisions based on gut feel because they have not completed either of these two steps with strict measures. Eventually, the question lands on the desk of a senior manager who feels ill-equipped to make a sound decision. These senior managers worry about the impact of their decisions because they know they risk misdirecting internal resources, leaving money on the table, or pricing their offerings out of the market.

CMA's strive to lead organizations to implement best-in-class practices for decision making and results management. Implementing measures to manage the price/volume trade-off has been a daunting task because finding accurate measures of price elasticity is elusive. However, by using The Variance Tree to help define and analyze the appropriate data, CMAs can bring clarity to the price/volume trade-off even if they are not yet able to forecast the alternative outcomes with accuracy.

### The Variance Tree

The Variance Tree aims to break business performance into its fundamental driving elements. It is similar to budget variance analysis – performing comparisons (calculating variances) and splitting the performance metrics into sub-elements. However, the difference lies in two key areas. First, we are comparing actual to actual rather than actual to budget, and second, we are focused on understanding what is driving the changes to the revenue line.

We compare current actual performance to a prior period because we want to see what has been happening to our business at the customer interface. The Variance Tree helps us understand how well a business performed, as opposed to highlighting whether it had high-quality plans and targets. Usually comparing this year's results to the same period last year will provide the best insight, as it naturally removes any effects of seasonality.

Building a Variance Tree requires one to assess what is truly driving the business. The Variance Tree focuses on the revenue line (or customer margin line) of the P&L (profit and loss) and using price/volume/mix variance calculations, it decomposes changes in business performance to illuminate the business issues. For example, has the quantity variance (in dollars) decreased because the business has fewer customers, or because its existing customers are buying fewer units?

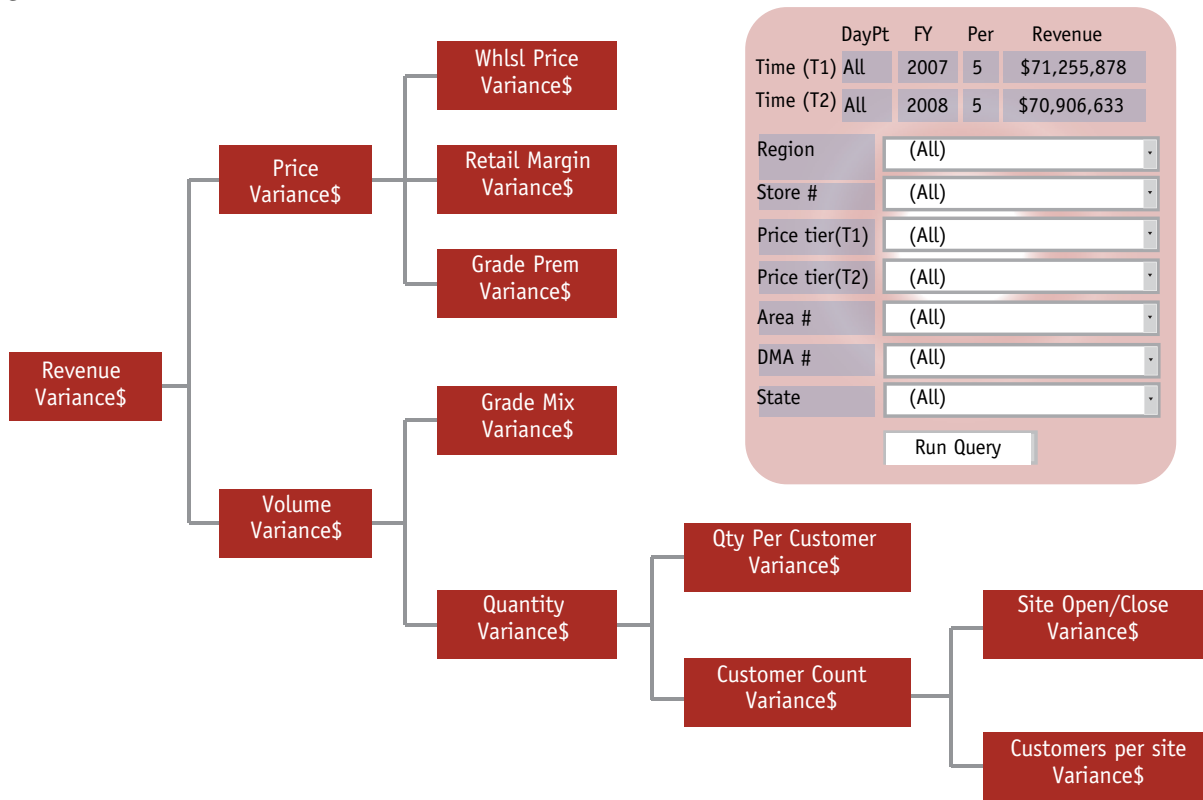
Using a simple example of a chain of gasoline retailers, typical factors that drive a business are illustrated in a tree (Figure 1).

The first split is between price and volume. The impact of price changes can be further split into changes caused by increases or decreases in the price of wholesale gasoline, the retail margin and the premium the business charged for mid and super grades of gasoline. Similarly, as we use The Variance Tree to understand the impact of volume changes, we can see a change in the mix of grades, and the total number of liters sold. Working further down the tree, the impact of quantity can be split into quantity per customer and number of customers.

Understanding the results in a quantitative way helps managers raise key questions about recent performance. The Variance Tree highlights how a promotion has (or has not) brought in



**Figure 1**



new customers, impacted the mix, and affected average price per customer. The Variance Tree should be built from the transaction level up, and therefore, provides the ability to drill into item level performance to help diagnose performance issues.

**CMA's strive to lead organizations to implement best-in-class practices for decision making and results management.**

**Case Study: Decision making with The Variance Tree**

The Variance Tree has been developed as a key first step towards helping managers manage the price/volume trade-off by decomposing the impact of recent decisions. This historical view can help challenge the mental models being used to make decisions. In the future, the same data can be extended to translate historical performance into a forecast of future results.

In these challenging economic times, businesses are using price reductions and promotions to maintain volume. While The Variance Tree won't show what would have happened if a business did not reduce its prices or offered a promotion, it

will clearly show the impact. For example, at one restaurant chain in the family dining segment, managers chose to promote entrees at \$5.99. This price point was considerably below historical average meal prices. The result was a significant negative price variance (on the meals where the price was reduced) and negative mix variance from customers who traded down from higher priced meals. However, because the promotion was done as a stand-alone offer without a plan for bundling or up-selling, there was no offsetting increase in units per customer and nothing to offset the negative mix. Customer count variance was the only potential offset and was the only unknown in the analysis. (How badly would the customer count have declined if the promotion had not been executed?) The Variance Tree showed how the business had to depend on the promotion to bring in substantial traffic because it did not manage the risk of mix erosion. When the flow of customer traffic didn't materialize, performance eroded. By thinking about the impact of decisions from the perspective of The Variance Tree, the business can articulate and quantify the risks it is taking.

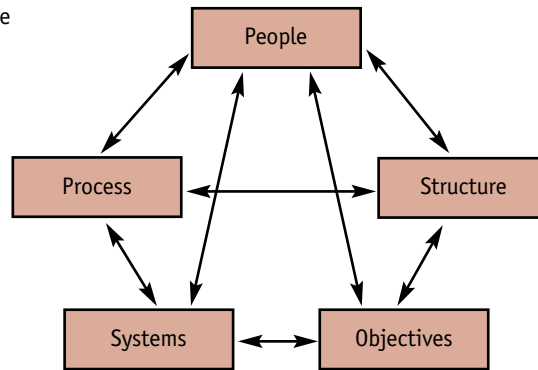
**Planning for successful implementation**

As with any change to the business metrics, developing a change management strategy is critical to a successful implementation. Using a framework like the one shown in Figure 2 helps teams think through the organizational changes required.



**Figure 2**

- People
  - Skills, experience, mang't style
  - Resources and budget
  - Strategic vs. operational
- Structure
  - Reporting, authority matrix
  - Roles
- Objectives
  - Business objectives
  - Key Performance Indicators
- System
  - Tools, Rules
  - Data access, software
- Process
  - Documentation
  - Workflow, automation



yet the rest of the Tree seems to be in line with overall results, perhaps a competitor has made a move in that region. If there are price changes in that region that are out of sync with the rest of the business, perhaps that regional manager has been too aggressive in taking price increases.

Once the problem (or a success) has been properly diagnosed, developing the solution becomes significantly easier – a problem well-defined is half solved. Senior managers will naturally start addressing the accountability issues that this tool will uncover. They will also begin to rely on it to help them make future pricing decisions.

## Determining price elasticity is difficult because not all volume changes are due to changes in price.

The Holy Grail on this journey is to develop an understanding of price elasticity. Price elasticity is defined as the percentage change in volume in response to a per cent change in price. Determining price elasticity is difficult because not all volume changes are due to changes in price. However, with the data in The Variance Tree, you can begin to tabulate the history of price and volume changes. If you supplement this analysis with won/lost performance analysis, chronology of external events (e.g. promotions) or pricing research, it will sharpen the picture. And once you understand elasticity you can build a forecast of volume and margin as a function of price. This is the point where you have moved the business from managing on gut feel with mental models to controlling the price/volume trade-off with an objective model built on solid analytical principles. ■

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Implementing The Variance Tree is a change to the objective setting and measurement process. It requires training to upgrade skills. With one client, we found that they avoided the concept of mix for a year until it turned from a positive to a negative variance. It then became a key topic for managers in all functions. The lesson is that timing and patience are vital to changing behavior. Process and systems changes will also be required – where will the results be reviewed? How will they be linked to existing reporting? Finally, finding reliable, accurate data that reconciles to other reporting will build credibility for your tool.

We have found that prototyping the tool using spreadsheets is a way to use real data as you build support for developing a more robust tool that integrates into existing review processes and performance objectives. It has also been effective for breaking accountability for performance into its composite parts. Using the retail gasoline example, it is wise to make marketing, rather than sales, accountable for the mix of premium gasoline grades. Similarly, the regional manager has little influence on whether outlets are opened or closed in their area; that is the responsibility of business development.

As you build support for a Variance-Tree initiative, remember that

designing the tree is an exercise that is unique to your business and critical to the ultimate success of your initiative. Price, volume and mix are the starting point, but an understanding of the business is necessary to develop the next tier. We have found that experienced sales and marketing managers are a good source of input. This is where their gut instincts can be put to good use. They are usually thankful to see metrics that help them sharpen their focus on the business.

### A continuous cycle of improvement and journey to pricing excellence

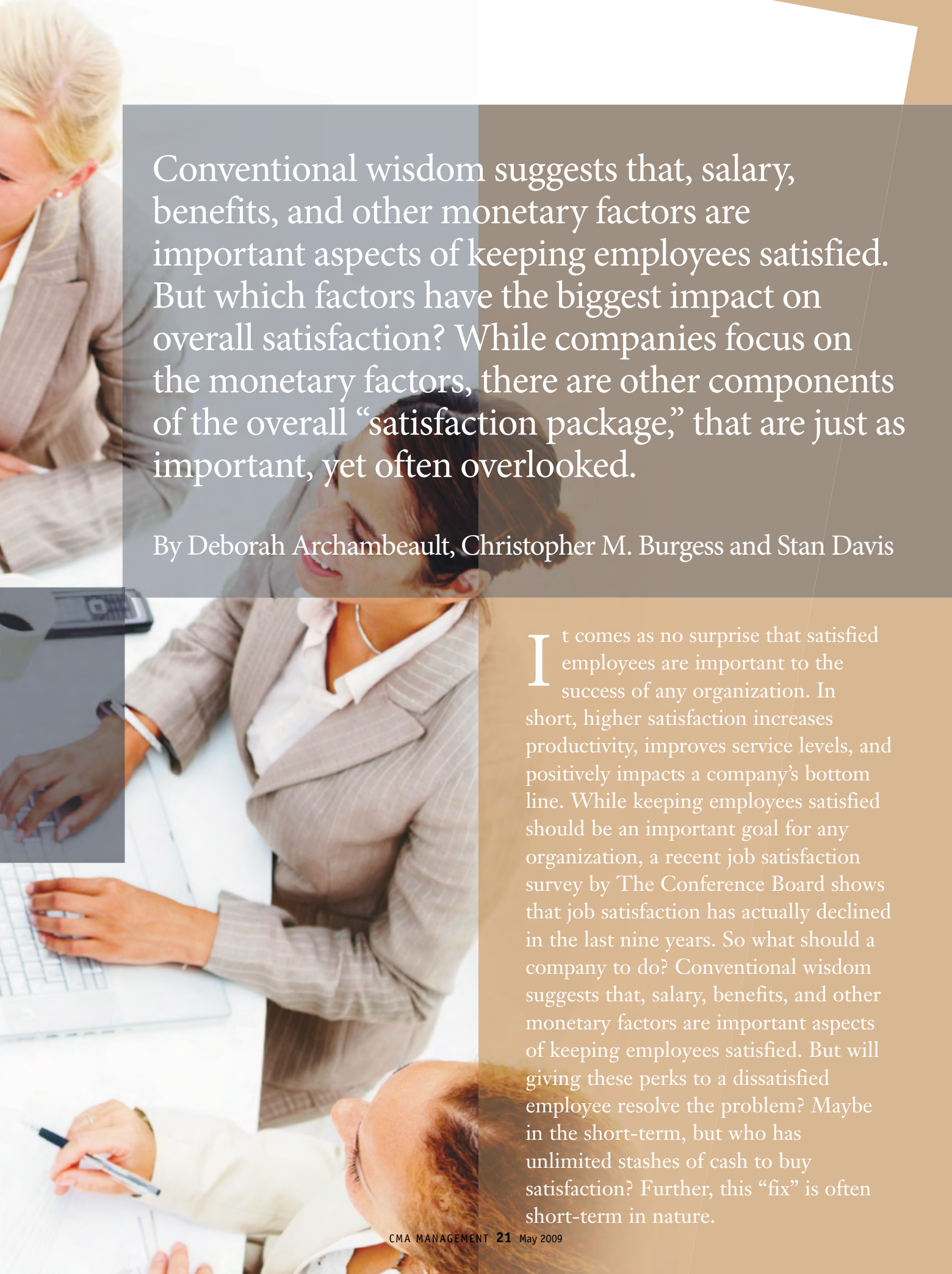
The Variance Tree is a step in the path to bring greater certainty to pricing decisions. Ultimately, by having a forecast of the volume impact under different pricing assumptions, you can forecast the profit impact. Adding the long-term impact on customer loyalty gives you a complete model. There are several steps along the way to that goal.

Because The Variance Tree is built up from item level transactional data, the variances can be broken into their composite parts. You can split the mix branch into key items to see what mix trade-offs customers have made, and how these have affected the business. If results have been negative or unexpected, you can take action to remedy the situation. If customer counts have fallen in particular regions,



Is something missing  
from your company's  
satisfaction package?





Conventional wisdom suggests that, salary, benefits, and other monetary factors are important aspects of keeping employees satisfied. But which factors have the biggest impact on overall satisfaction? While companies focus on the monetary factors, there are other components of the overall “satisfaction package,” that are just as important, yet often overlooked.

By Deborah Archambeault, Christopher M. Burgess and Stan Davis

It comes as no surprise that satisfied employees are important to the success of any organization. In short, higher satisfaction increases productivity, improves service levels, and positively impacts a company’s bottom line. While keeping employees satisfied should be an important goal for any organization, a recent job satisfaction survey by The Conference Board shows that job satisfaction has actually declined in the last nine years. So what should a company do? Conventional wisdom suggests that, salary, benefits, and other monetary factors are important aspects of keeping employees satisfied. But will giving these perks to a dissatisfied employee resolve the problem? Maybe in the short-term, but who has unlimited stashes of cash to buy satisfaction? Further, this “fix” is often short-term in nature.



In fact, studies show that while adequate pay and other monetary benefits are necessary components of employee satisfaction, they are not the only determinants in maintaining a satisfied workforce. What we have learned over the past 12 years from working with small to medium-sized organizations is that employers often focus on monetary solutions, but overlook low cost or no cost opportunities to increase employee satisfaction. The suggestions that follow are just some of the possibilities companies can implement to increase overall employee satisfaction.

### Importance of factors in the “satisfaction package”

The overall menu of factors that contribute to employee satisfaction, hereafter referred to as the “satisfaction package,” include monetary factors and non-monetary factors. Monetary factors are the typical components of the employee compensation package that directly affect the employee’s pocketbook – e.g., salary, bonus, retirement plan, and benefit package. Non-monetary factors are items that do not directly affect the employee’s net worth, and include factors such as trust, communication, recognition, challenging work, and personal growth.

In fact, studies show that while adequate pay and other monetary benefits are necessary components of employee satisfaction, they are not the only determinants in maintaining a satisfied workforce.

As part of our work with companies that want to improve their performance measurement systems, we survey employees at the beginning of each engagement and ask them to rate how important various “reward/benefit” items are to them. The results demonstrate an incredibly high level of consistency from company to company on what factors employees consider most important. Table 1 presents a rank order of these select factors from surveys conducted on employees from many different organizations, ranked from most to least important.

In Table 1, non-monetary factors were ranked as high as or higher than many monetary factors. Of particular interest is the fact that two communication-related factors – “receiving positive comments from supervisors” and “being able to present ideas to management” – are rated as being more important than several

costly items such as cash bonuses, educational programs, parties, and time off.

### Factors that affect satisfaction

As the data in Table 1 shows, monetary factors do matter. Fortunately, so do the non-monetary factors. As part of our initial engagement survey, we ask employees to give us feedback on their satisfaction with a variety of individual “satisfaction package” factors in their current job, as well as an assessment of their overall job satisfaction. Three factors that have proven to have a strong impact on overall employee satisfaction are pay, fairness perceptions, and communication (e.g., the degree to which employees are satisfied with the level and frequency of communication within their organization). While that list of three factors is certainly not exhaustive, focusing on these three factors will demonstrate how the two non-monetary factors can be used to achieve a higher level of employee satisfaction without any changes to the monetary factors. Using these three factors, we will next present a brief analysis that illustrates how overall satisfaction levels are a function of more than just how satisfied employees are with their pay package.

It stands to reason that employees who are highly satisfied with all three of these factors would naturally be expected to have higher overall job satisfaction. From our surveys, employees that fit this description (e.g., high satisfaction ratings for pay,

**Table 1**

### How important are the following rewards/benefits?

Seven-point scale with seven = "Very Important"

Retirement plan	6.59
Insurance benefits package	6.49
Receiving positive comments from your supervisors	6.35
Being able to present your ideas to management	6.07
Receiving cash bonuses	6.03
Having your ideas implemented	5.72
Being involved in teams	5.68
Employer sponsored education programs	5.68
Social celebrations	5.06
Getting extra time off	5.04
Public recognition in newspapers or newsletters	4.28

communication, and fairness) had an overall satisfaction rating of 6.75 on a seven-point scale, where seven is the most satisfied. This is the most satisfied group of employees, as expected. As discussed earlier, however, the problem is that achieving high levels of pay satisfaction may simply not be feasible for the organization.

## Employees value fairness, open communication channels, and a solid monetary package.

What may be surprising, however, is that a high overall satisfaction rating is not solely dependent on achieving high levels of pay satisfaction. We have found that even with lower levels of pay satisfaction, when employees perceive that management is dealing fairly with them and they are satisfied with how management communicates with them, overall satisfaction levels are still very high (6.41). In fact, as Table

2 illustrates, fairness perceptions and openly communicating with employees can be just as effective in generating higher levels of overall satisfaction when compared to high levels of pay satisfaction. For example, employees who were highly satisfied with communication, but have lower satisfaction with pay, scored higher (6.41) than employees with high satisfaction with pay and lower satisfaction with communication (6.22).

Various combinations of these satisfaction package components produce different levels of job satisfaction, but the point is clear: employees care about more than just their pay. Please keep in mind that your satisfaction package can and should focus on many more factors than just these three factors, but these factors have proven to be particularly powerful in their impact on overall satisfaction, and serve as an illustration as to the role non-monetary factors play in overall employee satisfaction.

### Organizational strategies

If you feel your organization can benefit from improved satisfaction levels, try the following simple steps:

- Recognize employees for a job well done – both in front of their

peers (if possible) and in a one-on-one setting.

- Solicit employee feedback on ways to improve. When possible, implement employee ideas. When not possible, take time to explain why.
- Correct the perception of favoritism among managers (a morale killer and frequent employee complaint) when it comes to promotions, raises, and assignments by establishing clear objective measures and discussing the measures with each employee from the beginning.
- Be as open as possible when faced with difficult and unpopular decisions by sharing the rationale for the decision. In time, employees will learn to trust your judgment knowing you have made the fairest decision possible under the circumstances.

Employees value fairness, open communication channels, and a solid monetary package. As the data shows, two of these factors can be improved with little or no additional expense to the organization. With just a little effort and empathy (and maybe some training), first-line and mid-level managers can have a remarkable impact on how satisfied their employees are. By clearly laying out processes (and following them) and being as transparent as possible in communications, managers build a level of trust with their employees that can melt away the built-up frustration that grows from years of small raises, vague communications, and unexplained or unfair decisions. ■

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**Table 2**

### Pay, fairness, and communication vs. Job satisfaction

Job satisfaction measured on a seven-point scale with seven = "Highly Satisfied" (■ = High Satisfaction, □ = Low Satisfaction)

Pay Satisfaction	Fairness Perceptions	Satisfaction with Communication	Overall Job Satisfaction
■	■	■	6.75
□	■	■	6.41
■	■	□	6.22
□	□	■	6.15
■	□	□	5.98
■	□	■	5.89
□	■	□	5.72
□	□	□	5.23

# Enterprise governance: Risk and performance management through the business cycle

Even when the dust settles, economic downturns will not be a thing of the past. Business cycles—which entail ups and downs by their very definition—are here to stay. If companies are willing to accept that, the key question becomes: How can organizations adopt reliable risk management “through the business cycle” to deliver sustainable performance?

By Wim A. Van der Stede



use the term reliable scrutiny to suggest that seemingly outstanding performance during boom times should be looked at with as much vigor as performance setbacks or outright losses during downtimes. It does not imply, however, that risk is to be entirely avoided. Risk is, and remains, the bedrock of enterprise. It allows for innovation and managed risk taking; a blend of tested and untested initiatives. Equally, the term sustainable performance does not refer to the performance of firms that have seen excessive returns during the boom years, but have only been able to survive by accepting bailouts. Sustainable performance has to be what the term suggests — viable in time. Reliable scrutiny and sustainable performance constitute the key elements in this article. They come together in what I will call enterprise governance and they have an important temporal dimension: “through the business cycle” and for the long-term.

### Hard times

Companies tend to let their guards down or become complacent when business is good and when performance is meeting or beating expectations. But they often have the opposite reaction when things are not going so well — when targets are not being met, or worse, when the firm faces losses — then companies tend to over-react or over-tighten their belts. This is perhaps quite an innate, natural reaction. But it is also an outcome of the management-by-exception approach that companies sometimes practice too blindly. This directs attention primarily, if not exclusively, to problem areas, assuming that all is well where and when performance meets or beats expectations. Some risk management practices, ironically, also have a built-in tendency towards such lopsidedness, particularly purely quantitative tools that don’t go far enough back in time, and therefore tend to look best when they should be looking worst — at the end of a boom. Regardless of the source or driver of such tendencies, the key point is that the level of scrutiny tends to move inversely and asymmetrically to performance.

Let’s discuss the inverse relationship between scrutiny and performance first. In the aftermath of a crisis, we hear calls for government action. Everyone is eager to listen to risk managers. The business press is filled with risk management articles. This is as true since the onset of the current crisis as it was following the corporate debacles, such as the collapse of Enron and WorldCom, earlier in this decade. These earlier scandals spawned a slew of corporate governance and internal control policy developments around the world. But when the crisis has passed and the boom times return, the tone changes. Shareholders enjoy high returns and the appetite for scrutiny of all kinds quickly wanes, or worse, is dismissed as a “drag” on performance.

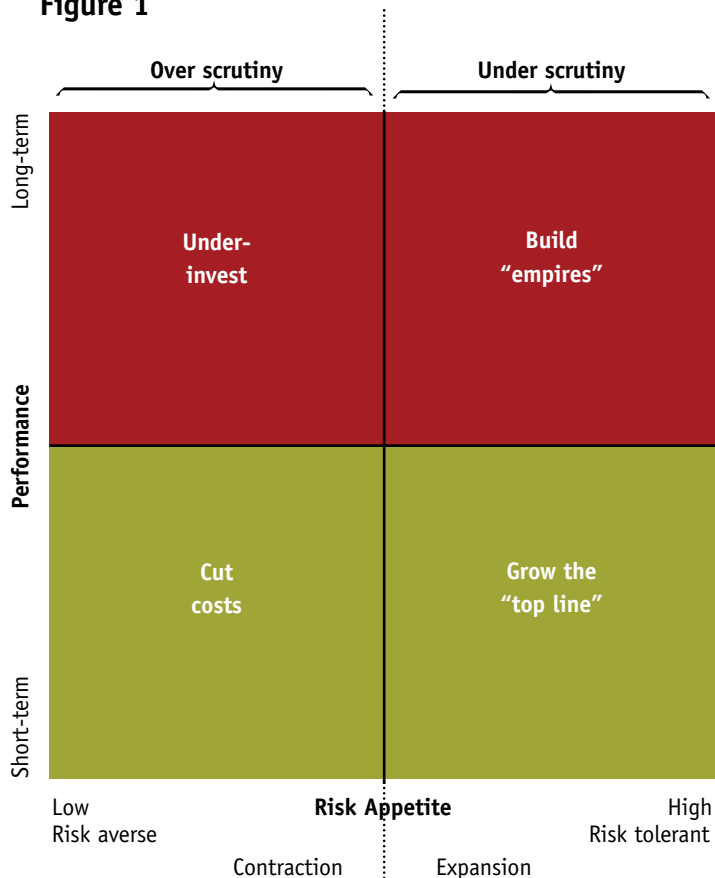
But not only do scrutiny and performance tend to move inversely to one another, the reaction to poor performance appears to be asymmetrically stronger than is the level of

healthy skepticism when performance is strong. In other words, the tendency inside many firms to investigate an unusual profit is smaller than the tendency to investigate an unusual loss. But, as post-mortems of crises suggest, unusual profits are often where the seeds of future distress are sown. The unusual profit may be a sign that managers have been too aggressive, been taking too much risk or been excessively short-term focused.

Put together, then, companies tend to oscillate between under and over-scrutiny triggered by strong versus poor performance, respectively. Under scrutiny often prevails during expansion times when there is a “top-line” focus driven by aggressive, rose-tinted growth plans, “can do” attitudes, minimally-required compliance and control weaknesses. It often results in “empire building” through risky investments and ill-advised acquisitions. Over scrutiny, on the other hand, is manifested by tightening the screws during contractions through cost cutting, lack of investments (even worthwhile ones), balance sheet “clean ups” and divestments (sometimes at huge discounts) driven by too much risk aversion, over-compliance in the face of potential litigation and other stifling, protective attitudes. Neither seems ideal.

As an illustration, consider the matrix depicted in Figure 1. On the right-hand side of the matrix, when times are good and capital is readily available, companies are upbeat and risk tolerant, complacent or under-scrutinizing. In other words,

Figure 1



their risk appetite is high and they tend to emphasize growth. This can often be reckless growth, however, which may show good bottom-line performance effects in the short-term because some cost savings have quick effects while other costs are amortized or “taken out” as one-off items. The value-creating synergies on which such “empire building” is presumably based, often fail to materialize in the longer term, however. Hence, there is an important temporal dimension to this, which is depicted along the vertical dimension of the matrix. Whereas the less-than-ideal scrutiny and higher-than-desirable risk taking during the expansion drive may result in subpar returns in the long-term, the performance effects in the short-term often look good.

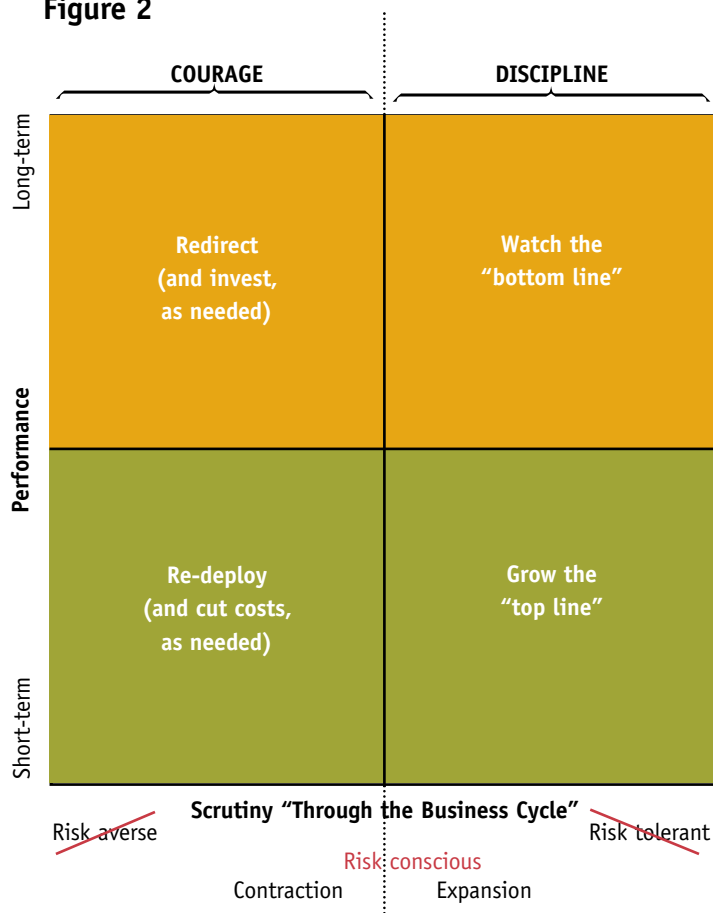
Although wielding the axe might seem to fix the bottom-line in the short-term, it might come back to haunt the firm by putting its future at risk.

On the left-hand side of this matrix, when the going gets tough and performance is weak or not meeting expectations, companies often revert to being too risk averse — that is, their risk appetite is low and their risk taking declines. To deal with their performance challenges, companies often go for the low hanging fruit — they cut costs, cut R&D, and tighten their hurdles to accept capital projects, thereby often under-investing in otherwise promising projects. Again, the short-term results of such actions often show quickly with good effect due to the lower costs and one-time charges that are dismissed as exactly that, but the long-term effects are more dubious, often hampering long-term potentials for value creation, effectiveness and competitiveness. Although wielding the axe might seem to fix the bottom-line in the short-term, it might come back to haunt the firm by putting its future at risk.

The question then is, how can companies have the discipline in good times to watch both the top and bottom line; that is, to not over-reach their growth, and the courage in bad times to not only cut costs, but to also redeploy assets and redirect investments for the long-term? In other words, how can companies’ scrutiny be calibrated through the business cycle to make them appropriately risk conscious? This is depicted in Figure 2.

Note that in Figure 2, the color in the top quadrants has not turned green, as in the bottom of that figure. Rather, it is still a shade of amber to denote caution. This illustrates that companies should not seek to, or can believe to be able to, eliminate risk entirely. Measured risk taking is critical in

Figure 2



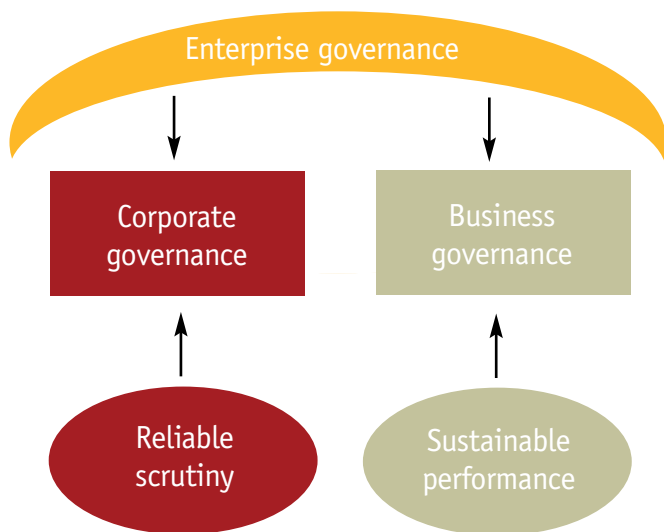
driving long-term performance and this inevitably involves uncertainty. Risk is, after all, what drives a wedge between a good decision and a good outcome, where it must be accepted that even good decisions made under appropriate scrutiny and sensible restraint will not always have good outcomes. But the more risk conscious firms are through the business cycle, the more likely they are to affect good outcomes.

### Enterprise governance

The notion of enterprise governance is a conceptual framework to summarize the above points, bringing reliable scrutiny and sustainable performance together under one umbrella, thereby emphasizing how firms might think about aligning them.<sup>1</sup>

As shown in Figure 3, on the right, enterprise governance entails what is called business governance, which has to do with performance, both short- and long-term, hence the term sustainable performance (as opposed to its myopic variant). On the left, there is corporate governance, which relates to conformance, risk management or scrutiny, again both in the short and long-term, hence the term reliable scrutiny. Regardless of the exact labels one wishes to use, the essence of the framework is that it consists of three elements: performance and scrutiny, both cutting across time; that is, with a concern for the long-term, hence the emphasis on “reliable”

Figure 3



scrutiny and “sustainable” performance.

Despite the level of abstraction, the framework resonates with formal risk management approaches such as COSO’s Enterprise Risk Management (ERM).<sup>2</sup> When studying ERM’s formal definition, one will see that it posits risk management as a tool to provide “reasonable assurance regarding the achievement of entity objectives,” which clearly marries risk (assurance) and performance (objectives). By doing so with reference to “risk appetite” and emphasizing “reasonable” assurance, it also suggests that risk is to be managed, not eliminated. As such, risk management is not only about ensuring that bad things do not happen, but equally about making sure that good things do happen. Moreover, COSO’s definition also mentions the “board of directors, management and other personnel,”— indicating that risk management needs to pervade the organization rather than being just a top management exercise or solely the concern of an appointed committee. Students of performance management would equally allude to several of these aspects as conditions for sustainable performance. Even though performance and conformance may be separable, they are not independent. Regardless of whether one takes a primarily performance management view or a primarily risk management view, it is hard to consider one without the other, especially if one has a long-term orientation.

However, research suggests that companies often still treat performance and risk management separately. For example, one study suggests that companies implement ERM primarily as a reaction to regulatory pressures and corporate governance requirements.<sup>3</sup> In other words, they don’t seem to do it primarily because it makes good business sense, but rather because they feel pressured to do so. But when asked about the benefits of risk management, these same sample companies hint primarily at

performance benefits, such as allowing them to make better-informed decisions, to obtain greater management consensus, to improve management accountability, to better meet strategic goals and to use risk as a competitive tool. Not surprisingly, they also mention some compliance benefits such as better governance practices and better communication with the board. They even mention some “cycle busting” benefits, such as reduced earnings volatility and increased performance. In other words, whereas many companies’ motivation to engage in risk management is reluctantly compliance driven, this study suggests that the benefits are primarily performance related. These findings also suggest that risk and performance management should not work against each other or be counter cyclical. Instead, scrutiny and profitability and scrutiny and earnings stability (the opposite of earnings volatility) appear to mutually enhance each other.

### Sensible restraint

Unfortunately, there isn’t a simple solution on how to handle or prevent an economic downturn. But I do hope to have exposed the tendency that risk and performance management may become misaligned. Awareness of this phenomenon perhaps even may seem too trivial to suggest. But asking the tough questions, even when nobody else does because they are too consumed by their current successes, appears harder than it sounds. Examples are not hard to find. In respect of the current crisis, it would have been good to ask questions about whether “millennium finance” really was the panacea it was believed to be. Instead, however, “Banks which decided not to invest in these instruments [complex financial products whose risks were either under-estimated or misunderstood] were often pilloried for being boring.”<sup>4</sup> Healthy scrutiny should also be encouraged throughout the organization. Risk management is not just about structure and systems, but also about organizational culture. If there is no healthy scrutiny in the organization, then everyone just assumes that someone else has considered the risks—a common fallacy that just further inflates the bubble. ■

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<sup>1</sup> *Enterprise Governance: Getting the Balance Right*, IFAC/CIMA, 2004 ([www.cimaglobal.com/enterprisegovernance](http://www.cimaglobal.com/enterprisegovernance)).

<sup>2</sup> Committee of Sponsoring Organizations of the Treadway Commission, *Enterprise Risk Management — Integrated Framework* ([www.coso.org/Publications/ERM/COSO\\_ERM\\_ExecutiveSummary.pdf](http://www.coso.org/Publications/ERM/COSO_ERM_ExecutiveSummary.pdf)), September 2004.

<sup>3</sup> Gates, Stephen, “Incorporating Strategic Risk into Enterprise Risk Management: A Survey of Current Corporate Practice,” *Journal of Applied Corporate Finance*, Vol. 18, No. 4, pp. 81-90, Fall 2006.

<sup>4</sup> Mervyn King, Governor of the Bank of England (BBC: *Governor Attacks City Risk-taking*, 28 April 2008).



# Overcoming trying times

Matthew Scott, CMA, shows the value of remaining optimistic during economic challenges.

By Andrea Civichino

**M**atthew Scott, CMA, is always ready for a new challenge. And despite the crisis that has been unfolding in Canada's manufacturing sector, Scott and his team have reasons to remain optimistic.

"The role is also coupled with traditional operations. It's great because I sit with the rest of the leadership team and establish the direction and then implement the plans ... it's very rewarding."

Scott is the director of operations and strategic development of ZTR Control Systems and TR Electronic – the brainchild of four local London, Ont. entrepreneurs who started the company over 20 years ago with a vision to make locomotives in the railway industry more fuel efficient and environmentally friendly. ZTR Control Systems is also involved in the design and development of monitoring and control system solutions for various industries. The company has had a special focus on the railway, power



Photo: Steve Grimes, London





generation and industrial equipment sectors. ZTR's Connected Assets Division provides services through remote monitoring and systems management solutions. To get there, the foursome also formed TR Electronic North America – a source of income and cash to fuel the entire R&D for ZTR Control Systems. TR manufactures and distributes automation and industrial sensor products within North America.

In 2005, ZTR was acknowledged by the London Chamber of Commerce as the recipient of the Business of the Year award for its outstanding performance, business achievements, innovations in product service and commitment to community.

“It’s tough pulling together what are three very diverse entities under one common umbrella,” Scott says. “Three very different businesses exist and it’s engrained within the divisions that each has a different set of customers, strategy and vision. We pull it together corporately, but there certainly is some unique identity in there too,” he adds.

Scott joined the ZTR team in the late 90s and stayed for three years before leaving the company to take on other projects. Scott, an engineer at heart, founded and operated his own computer sales and service company, but still kept close ties with his former employer. After holding several progressive roles with Bell Canada and Honda Canada Manufacturing in finance, engineering, operations, and planning capacities, the position of director of operations and strategic development became available at ZTR. Scott returned to ZTR because it “seemed like a great fit.”

“I was here in the past and I was aware of some of the new things that they were doing,” he says. “My role as director of operations and strategic development is unique, even for a mid-sized business. On the strategic side, my role involves planning, business development, looking for new partners for our company, and leading the organizations through its strategic planning process,” he adds. “The role is also coupled with traditional operations. It’s great because I sit with the rest of the leadership team and establish the direction and then implement the plans ... it’s very rewarding.”

During his time away from the company, ZTR was

experiencing a growth trajectory. Within four years of rejoining the team, sales have nearly doubled. He says growth has been good in Canada and the U.S., along with export sales to Australia, New Zealand, Africa, India, and Pakistan.

In 2005, ZTR was acknowledged by the London Chamber of Commerce as the recipient of the Business of the Year award for its outstanding performance, business achievements, innovations in product service and commitment to community. ZTR went on to win Ontario’s provincial award the same year.

Today, Scott spends the majority of his time working on the TR Electronic business. Although the company has enjoyed the progress and success it’s made over the past 20 years, the team is cognizant of the challenges that are up ahead.

“With TR, it’s challenging because we’re so heavily linked to manufacturing,” he adds. “However, we’re seeing positive gains and we’re also committed to helping support the sector. Despite what’s happening in the economy, we need to keep moving the organization forward ... that means meetings with new partners, being smart with inventory, conducting market analysis and relentlessly supporting customers,” he adds.

“There are a lot of household names in the manufacturing automation industry and TR has traditionally had a tough time with brand recognition, but we’ve positioned ourselves as a vendor that helps to make North American manufacturing more competitive ... we’ve stood by that and have the right pieces in place,” Scott says. “We’re making gains. We’re up over 25 per cent right now in the U.S. Canada is lagging a little behind, but there is some good news for us right now and I think it’s because of the way we’ve positioned ourselves. We’re not the cheapest supplier on the block, we’re not providing the lower end commodity, but we’re providing things that truly make manufacturers competitive. The trick is getting out there and conveying that message during these times.”

Scott says he’s using his background in electrical engineering and computer science degrees from the University of Western Ontario, coupled with his CMA designation, to navigate the company during these trying times.

“Enrolling in the joint CMA/MBA program at Queen’s University looked like a good choice at the time, and it proved to be,” he says. “It’s one of the best experiences I’ve ever had. I wanted to enroll in the program because my strength has always been identifying technical solutions for business problems. I have a solid background in engineering and computer science. Although I already had the technical skills, I saw the CMA has a natural fit to help me sharpen my strategic and financial skills.”



“For me it’s stepping back, looking at the organization as a whole and making sure that we’re looking after the big decisions as opposed to just getting caught up in the smaller issues. It’s all about leadership and taking on new challenges head on.”

Scott’s CMA designation has opened the doors for many other opportunities, including his desire to give back. When he’s not analyzing investments, managing financial systems or developing new strategies for ZTR and TR, Scott sits on the board of directors for Western Area Youth Services (WAYS); a local non-profit, and is also an active member of Tech Alliance’s venture services team – an organization that provides early stage

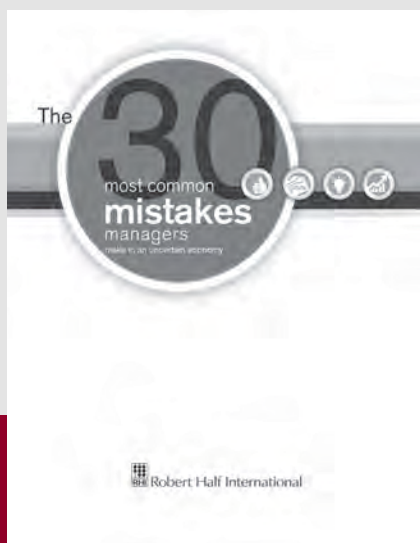
advice to local entrepreneurs. He’s also a project adviser to the Queen’s School of Business on new ventures, international business and management consulting projects. “Being involved in the community as a CMA is important to me as I believe we have a lot to offer...at the same time, it’s important that I’m home in time to read to my kids some nights. My two-year old has a short memory and I need her to remember what her dad looks like,” Scott adds.

Scott is a proponent of taking the time to plan, making well-informed decisions, watching them come full circle, and appreciating the results at the end of the day.

“For me it’s stepping back, looking at the organization as a whole and making sure that we’re looking after the big decisions as opposed to just getting caught up in the smaller issues. It’s all about leadership and taking on new challenges head on.” ■

Andrea Civichino is the editor of *CMA Management*.

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# Fostering innovation in a firm

A book review of *The Game-Changer* by A.G. Lafley and Ram Charan

Reviewed by Patrick Buckley, CMA, PhD

One trend in many industries is that profits slide when products are commodified.

A.G. Lafley and Ram Charan discuss one way of countering this trend in their book *The Game-Changer*.<sup>1</sup> They recommend having continuous innovation to counter commodification.

Lafley and Charan prefer fostering innovation over other methods of increasing profits such as mergers and acquisitions or cost control. Cost control is a defensive strategy and mergers and acquisitions should only be carried out until all good opportunities are used up. Innovation, on the other hand, can occur an infinite number of times.

Lafley is CEO at Procter and Gamble (P&G) and Charan is a well-known management consultant. Innovation was the tool used by Lafley to turn P&G around when he became CEO in 2000, after a lengthy career with the company. When I first glanced at *The Game-Changer*, I thought it would just be a story about Lafley's success at P&G. Instead, the book contains many examples of other prosperous firms along with industry-wide trends.

There are many examples in *The Game-Changer* that show how innovation alters the game that a business plays with competitors. Disruptive innovations are more likely to be a game changer than incremental innovations. A couple of years ago, a manufacturer of bicycle components faced a downturn due to a decline in the market. The demand for luxury components ceased when seven-time Tour de France champion, Lance Armstrong, retired. The company thrived again after reframing their competitive landscape with the disruptive innovation of coasting bicycles. These are easy to use and appeal to the new market segment of casual bicycle users.

One theme of *The Game-Changer* is having

innovations that focus on the consumer. P&G found their focus improved when they started using immersive marketing research along with their traditional focus groups. Immersive research includes living with consumers and working in small stores. Immersive research is particularly useful in developing countries where P&G hires people who are in a much wealthier socio-economic class than its target market.

Lafley and Charan differentiate between innovation and invention. Innovations are inventions that are profitable, or show true potential of making a profit. A company is more likely to have innovations when corporate strategies are developed with a focus on consumer needs rather than technological developments. A chemical manufacturer adopted a strategy to promote only innovations rather than following their previous practice of promoting any invention that was seen as good technology by their research and development laboratory. The new strategy is effective since the firm implemented structural changes that bring together individuals from the silos of marketing, manufacturing, and research.

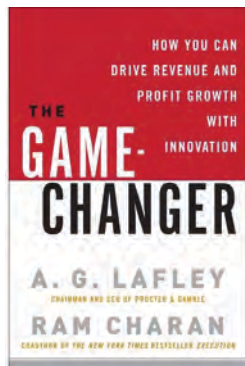
Another theme of *The Game-Changer* is the impact of social interaction on the process of innovation. One way of increasing social interaction is through structural organizational changes like those implemented at the chemical company. Another way is altering who goes to training together. Traditionally, at P&G, leaders from different business units and functions attended training together. Now, P&G finds more success when an entire leadership team is sent to their training facility as a group.

Lafley and Charan summarize their message in eight principles: put the consumer first, strive for achievable goals, focus growth strategies on innovative projects, build on core strengths, create organizational structures that support innovation, develop systems for turning innovative concepts into commercial products, promote a connected culture, and hire leaders who inspire innovation. Their presentations of these principles are amplified by insightful questions at the end of each chapter.

*The Game-Changer* contains these and other ways for corporations to stay ahead of the competition through innovation. Progressive firms also track their level of innovation with metrics such as the number of prototypes that are tested with consumers, the speed in developing each prototype, and the number of employees who work on innovative projects and eventually become managers. Companies that rank high on these measures are game changers in their marketplaces. ■

Pat Buckley, CMA, PhD, is an Ottawa-based systems analyst.

1A. G. Lafley and Ram Charan, *The Game-Changer: How You Can Drive Profit Growth with Innovation*, Crown Business, New York, 2008.







# How to generate returns when the markets won't do it for you

Like a surfer unsure of his chances of catching another wave as he is swept out to sea in a rapidly moving current, investors are questioning their investment strategies now more than at any other time in modern history.

By Craig A. Machel

The rapid declines in the global stock markets have had a dramatic impact on the majority of investor portfolios. Why? Because the average investor is dependent upon the upward movement of the stock markets in order to make money.

This reliance on market movement for investment gain is commonplace, but not commonsense. Markets have no predestined path. Despite what financial models want us to believe, the markets weren't designed to generate returns of eight to 10 per cent annually. And they haven't always done so.

Let's look at the facts, using the Dow Jones Industrial Average (DJIA) as the proxy for U.S. economic and market growth. From 1900-2008, the DJIA averaged a return of 7.2 per cent per year. Not bad. But consider that this is an index return: it does not include dividends, fees, or taxes or reflect inflation — all of which are major factors on an investor's return experience. Also consider that most of us don't have the luxury of a century to invest, during which the law of averages can smooth out the rocky years.

Being a bit more realistic with our data, if we dissect the DJIA into 20-year time frames (a more reasonable time period to reflect saving for retirement), we reveal a much different scenario than positive annual returns at over seven per cent. Starting from 1900 again, we can look at 88 rolling time periods of 20 years. In only nine of those periods — just nine times in over 100 years — the DJIA produced a compounded annual average return of 9.6 per cent or more. Moreover, in all but one of those nine years, the returns corresponded with what led to the technology bubble of the late 1990s. So, over the course of 100 years, the strongest average annual returns preceded one of the worst bubbles that effectively erased most investment gains for those



participating in the markets at the time. What history actually shows us is that there is no reason why the market must provide a certain return over a select period of time. They are, have been, and will likely remain unpredictable.

So why do so many investors put themselves at the mercy of market movements? I believe it is because they don't know they have another option. They are unaware of the fact that there is another way to participate in the equity markets that is not dependent on positive market returns for growth. This enhanced, non-correlated approach to equity investing is called a hedge strategy.



### Long-term strategy

In 1949, A.W. Jones, credited as the father of the hedge fund industry, presented this innovative alternative to traditional equity market investments. He realized that markets are unpredictable, and thus, developed a strategy that didn't rely on predicting market movements to succeed. In an annual letter to partners in the fund, he described his approach: "Such a fund, being fully hedged, has a market risk of zero and all net gains or losses will be attributable to good or bad stock selection, none to the action of the market."

Hedge solutions have been helping affluent investors make money in all market conditions for decades. These days, there are many different types of hedge fund strategies. My focus for this column will be Jones's original approach: the long-short strategy.

The goal of any authentic long-short strategy is to generate returns and minimize losses regardless of the direction of the market. This is achieved by constructing a portfolio that holds both attractive investments poised to grow (long positions) and unattractive yet overvalued investments likely to drop in value (short positions). By holding similar numbers of long and short positions, the hedge fund manager is able to provide more positive returns and fewer and smaller negative returns than those of the broad market. It makes sense if you think about it: whether the market goes up or down, half of a long-short portfolio is likely to benefit. So it truly doesn't matter what the market does. This is why most long-short managers have been riding recent market volatility quite well (not to mention posting strong performance in more positive markets).

With hedge funds, the markets don't matter, but your portfolio manager does. The performance of a long-short strategy is dependent on the manager's ability to be tactile and select the right stocks. Not all long-short funds are created equal. Fortunately, it is easy to sort through this asset class and find an authentic hedge strategy by examining five key factors:

**Fund structure:** The first thing you want to look at in any hedge fund is its structure. Does it have independent relationships with partners integral to its operation and security? Is this structure properly documented? Basically, you're looking for outside party oversight of the fund's operations. The lack of an independent and accountable fund structure

behind the scenes raises a red flag as to the integrity and security of the firm, and is the root of the problems with recent high profile hedge fund frauds.

**Investment process:** The second aspect you should examine in any hedge fund is its investment approach. What parameters are set out by the fund's investment managers? Will they manage a true long-short fund or is there potential for digression? And, finally, consider whether the investment process is consistently adhered to: was there ever a large bet or one-time bias, or has the long-short style continued since inception?

**Leverage level:** What is the leverage range limit set for this fund? How is leverage being employed—and when? Long-short funds normally set leverage limits to a 2:1 ratio. (As a point of reference, a typical first-time homebuyer applies leverage at a 4:1 ratio.) While some leverage is necessary to implement this strategy, consider a fund with a lower leverage level.

**Capacity limit:** Total assets in a fund can impact the success of any strategy. Will the fund limit capacity to ensure it remains nimble enough to execute its strategy? Hedge funds act proactively in order to lock in gains and protect capital. A fund with billions in assets simply can't move between positions quickly enough without hurting its own return. What you're looking for is a fund that has set a reasonable capacity limit in order to continue to be effective.

**Manager incentive:** Finally, you want to consider portfolio manager incentives. Does the fund offer compensation linked to positive fund performance? Equally as important, do the managers and principals have their own skin in the game? The incentive to work hard in order to limit losses and produce gains is significant if the portfolio managers themselves are amongst the largest unit holders.

During this continued state of uncertainty, it is prudent for investors to be exploring less volatile solutions in order to protect their savings. We don't have to be captive to the markets in order to save for our retirement. Jones figured this out over 60 years ago. He developed a strategy that diminishes the risks associated with the uncertainty of the markets and can grow capital without relying on market movements to generate returns. It worked then—and it's still working now.

An authentic long-short hedge fund can enhance the risk/return profile of your portfolio. In fact, true hedge strategies are an important element in any properly diversified portfolio. Armed with the five key factors to assessing hedge funds, you can now enter this asset class and make a good selection for yourself. Making this choice can help you ride a more consistent and predictable investment wave, giving you a clearer view towards your future lifestyle and retirement plans. ■

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*The opinions contained in this article are those of the author and are not necessarily those of Blackmont Capital Inc.*



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# When IT vendors don't meet expectations

IT invariably involves dependencies on outside vendors. When they don't perform as expected, this can wreak havoc on an organization.

By Jacob Stoller

"You run your business and we'll worry about the technology." This makes a lot of sense from an IT buyer's perspective. Managers, after all, can be more productive in their own line of business than they can be trying to sort out IT. There's a catch though — when IT vendors don't perform as expected, organizations may scramble to find a solution.

This creates a bit of a balancing act. On one hand, organizations need to trust vendors to do their job; otherwise the relationship is of little value. On the other, managers need to be cognizant of the dependencies and their potential danger, especially given the current instability of many companies, IT or otherwise. "This is a time when organizations really need to take a look at all of their vendor relationships," says Andy Woyzbun, lead analyst with London, Ont.-based Info-Tech Research Group.

**Problems with an ongoing service, such as telecommunications or application hosting, could result in business interruption.**

Vendor relationships can be impacted by a variety of circumstances. "We don't see a lot of vendors going out of business, but we do see a lot of major changes that go on within vendors during the course of an agreement," Michael Kolm, vice-president, global sourcing practice, PricewaterhouseCoopers, Toronto, says. Technology companies, for example, are frequently acquired, often changing their priorities and their style of business. Another possibility is a vendor decision, through restructuring or otherwise, to



abandon a portion of their business. "The times are interesting," says John Le Blanc, senior counsel for Bank of Nova Scotia. "In the next year, I think we're going to see some rationalizing in all industries."

Regardless of any vendor's problems, the key, according to Woyzbun, is to understand the likely consequences of non-delivery and to create a plan to mitigate the risks. As a guideline, Woyzbun suggests looking at four areas: project completion, ongoing services, access to skills, and software. "It's really a question of going through the list of dependencies," says Woyzbun, "and identifying the ones that are most crucial."

For example, a delay in the rollout of a new application could result in a stalled business initiative. Problems with an ongoing service, such as telecommunications or application hosting, could result in business interruption. Unavailability of key skills could impact support or critical upgrades. The sudden discontinuance of a software application could leave a company without the tools to run their day to day business.

Project completion tops the list because it is the most common.



“That’s probably your biggest risk,” Woyzbun says. “The key, and I think it’s a good strategy in this economy in general, is to keep projects relatively short, or break a bigger project into a number of pieces so that at least you get the benefits of the intermediate stuff. It just reduces your vulnerability to getting stuck with a job half done.”

Dependence on ongoing services also carries considerable risk. For relatively straightforward services like telephone or Internet, the primary issue is familiarity with alternate suppliers. Woyzbun recommends building relationships with these vendors before any trouble starts, as there’s likely to be a rush to their door if a major supplier fails. “If you’ve had conversations with these people ahead of time,” says Woyzbun, “it’s a lot easier to get to the head of the line.”

### Establish a plan

For more complex services, such as the hosting and management of equipment by a service provider, more preparation is required. “If you happen to have your equipment at a co-location,” says Woyzbun, “and that particular supplier is running into financial difficulty and you want to bail, what’s your transition plan? Do you own the equipment? Do they own the equipment? Who are the competitors? How quickly can you move? It’s sort of like a disaster recovery plan.”

Service arrangements often involve deeper dependencies. Kolm refers to an emerging “third wave” of outsourcing, where vendors develop and then host and manage custom applications for their customers. Although the convenience of “outsourcing and forgetting” is appealing to managers, Kolm believes that a hands-off approach is a mistake. “There are a lot of problems in that arena,” Kolm says. “You need to retain the knowledge of how the application works, the overall enterprise architecture from a network and infrastructure point of view, and also from a data management point of view. The reason many of these projects fail is because the customer didn’t provide the right level of oversight, and needed more expertise in how to actually run one of these projects.”

According to Kolm, many of these projects are outsourced because companies can’t find skilled

individuals in Canada. Dependence on outside vendors for skills, the third area cited by Woyzbun, is particularly risky when the workers have developed an intimate knowledge of a company’s business. Woyzbun suggests cultivating personal relationships with these people, a step few companies take. “Be able to reach these people if the employer that they work for either is no longer in business or may have laid off an individual that you consider to be key,” Woyzbun says.

When it comes to dependence on software code, there’s little worry about major players like Microsoft, but with a smaller software provider, the case may be different. “Often, you’re getting smaller software providers that have a fantastic product, fantastic people, fantastic ideas, but they don’t have the depth or the weight,” says Le Blanc. “So your concern is their financial health. We have cases where we actually monitor financial statements of those types of companies.”

## In the process of reviewing contracts, Le Blanc often finds that buyers don’t have a clear picture of what they need and what they’re getting.

Another way to mitigate risk here is through an escrow agreement. Under this arrangement, the software source code is held by a trustee, who releases it if the software company becomes insolvent or otherwise unable to deliver on its obligations. This ensures that the software can be maintained properly if the vendor gets into trouble. A key point, says Le Blanc, is making sure that the code held in escrow is updated on a regular basis.

Looking at dependencies isn’t just a matter of ferreting out vendor weaknesses – it can also help companies sort out their own act. In the process of reviewing contracts, Le Blanc often finds that buyers don’t have a clear picture of what they need and what they’re getting. “Sometimes we as customers love to be able to say it’s the vendor,” says Le Blanc. “Sometimes it’s us. Have you put the right people on? Were you unrealistic in your expectations? Was your business plan a sound one from the beginning, or was your project plan something that was unreasonable?”

Economic circumstances are also causing some vendors to take a hard look at their contracts. “We’re getting calls from both sides,” says Kolm. “We’ve got a program with a number of service providers. Are they collecting all of the fees that they’re supposed to be collecting in their relationships?” When a vendor is under pressure, one of the first casualties will be unprofitable business. A customer might wake up one morning to find that the deal he/she signed, that seemed too good to be true, really was. ■

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# Business ethicists tackle issues of slavery and servitude in business

Slavery exists in Canada. Organizations and consumers blindly enter contracts and make purchase decisions without knowing that they are contributing to the problem.

By John Cooper

Imagine an elegant hotel in a large Canadian city ... a business meeting takes place in a well-appointed boardroom, but the discussion is not about electronics, auto parts or any other potential products and marketing ideas — it's about human trafficking and the trade in sex slaves.

Now imagine a factory on the other side of the world. Indentured workers sweat away their days, trying to work off mounting and unreasonable debts, working without the benefits of a safe work environment or overtime, and labouring to make products that will ultimately be sold in Canada at discount prices.

Both elements are tied together — by demand, coercion, money, cheaper products — and are linked by the efforts of activists who are pushing business people to re-examine the way they do business.

At heart is the need to create a set of better business ethics. For Harvey Wah Chan, director of ethical sourcing for Mountain Equipment Coop (MEC), it's about ensuring that the supply chain is run as ethically as possible, and that involves contracting for goods that are produced by factories that treat their workers well, pay them adequately, and adhere to environmental laws.

Chan recently joined Benjamin Perrin, assistant professor of law at the University of British Columbia and a faculty associate at the Liu Institute for Global Issues (which focuses on policy-relevant research on emerging issues) to present a lecture entitled *Slavery and the City*. The lecture outlined the humanitarian crisis of “modern-day” slavery, with a focus on the economics of the invisible and global network that makes up slavery, as well as



ways consumers, business and employees can make change happen.

Slavery within the context of business is difficult to define. There is sex slavery where (mostly) women and children are forced into prostitution and indentured slavery, says Lorraine Smith, an independent consultant and associate of Canadian Business for Social Responsibility (CBSR) — a non-profit, member-led organization mobilizing Canadian companies to improve business performance and make sound ethical choices.

“There are different ways to look at it,” Smith says. “Most people don't look at it as slavery as there are degrees of issues. One of the things we (often) see is bonded or indentured labour, when workers are required to work to reimburse a credit. This is often tied to migrant labourers in the developing world. They go to other regions as part of a promise of work, and then have to pay off travel and accommodations.”

Perrin, who has a background in international business, says human trafficking often impacts the service sector, taxi and e-companies and the trucking and hotel industries.



### Human trafficking in Canada

The recent Liu Institute event opened up opportunities to recognize the significance of the issue, Perrin says, on everything from the use of websites to sell people to the use of hotels to create “showrooms” for human chattel. Human trafficking in Canada earns criminals millions of dollars a year — a rough estimate is \$280,000 a year from each victim.

Perrin urges tourism-related companies to adopt a code of conduct (information is available at [www.thecode.org](http://www.thecode.org)), take a zero tolerance policy on unethical business practices and train staff appropriately to recognize possible infractions.

“We’re hopeful that some of the major hotel chains will sign on,” he adds. “Without the Internet, hotels, motels and cell phones, most of these human traffickers would not be able to be in business.”

On supply chain issues, companies like (MEC) work to influence their suppliers. MEC has been involved in a three-pronged approach to the issue of ethical sourcing:

- A factory audit program conducted by MEC merchandisers, auditors and the Fair Labour Association (an independent organization dedicated to ending sweatshop practices worldwide);
- Corrective action to find resolution through building trust by working with factory management, empowering workers and working with the industry; and
- Community involvement, where information is shared and local ethical sourcing practices are promoted and supported.

“In our supply chain, we deal largely with technical products, and there is a high degree of sophistication with the materials,” Chan says. “We deal with materials that need to be licensed. While MEC actively audits its supply chain, there is “vulnerability in the poverty-stricken population or among those with low education in that they will accept the jobs they are given and will end up working under duress.”

Examples of poor working conditions include: fines for taking washroom breaks, lack of a living wage, unhygienic surroundings, child



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labour, or discrimination on the basis of race, gender or beliefs. Chan says he looks for situations where workers are penalized. MEC takes steps to correct them, with an eye to removing emotional, physical and financial duress.

Chan admits that using influence to change behaviour in the supply chain can be challenging. Some factories, for instance, may only produce a small number of units for MEC on short-term contracts — they are limited in focus and don't see the long-term benefits of promoting better working conditions.

One also has to consider the costs involved. "You can change the price tag on something, and it will be felt at the register, and consumers only have so much tolerance for price increases," Chan says. "Finding the equilibrium is challenging."

Yet, ethical business practices are "a required cost," he adds. "Because we're talking about product integrity."

In the past, product integrity involved the questions: "Is it well-made, does it meet consumer needs, and is it well priced? But now we also look at environmental and social conditions," Chan says.

Chan says the Outdoor Industry Association (to which MEC belongs), has a committee that is tackling questions of integrity. "This group is trying to define the standards and then turn them into benchmarks."

Smith adds that it's essential that firms move past the denial stage and begin to gather information (most significantly — know what your products are made from and their sources), set goals for change and network with industry peers. Smith adds that organizations like the UN-based International Labour Organization ([www.ilo.org](http://www.ilo.org)) can help companies gain insight into promoting change.

As for where labour infractions occur, they happen all over the world, Smith says, including here in Canada. This multi-layered and complex issue requires careful, often painstaking research — and a significant corporate commitment.

### Handling the issue

The most basic step is to have a code of conduct in place — the code will govern how the organization will deal with its suppliers and how

it will work to ensure that ethical and social compliance standards are met. Additionally, companies can commit to implementation programs that include supplier training, long-term contracts with suppliers, and a commitment to cross-cultural relationship building.

Significantly, companies must let their consumers know how and why they are embracing change, Smith says.

"One interesting thing I'm hearing from companies who manage the social compliance aspect is that supplier companies that perform well for them, and who are compliant, also happen to be the companies that have the best quality and meet the timelines," Smith adds. "A factory that's clean, and where its workers are treated well, where rules are being understood, it's not a big leap to see that that is a well run company. Profits are better on products that come from factories that are run well."

As for Canadian consumer attitudes, while MEC tends to attract consumers who are environmentally and socially conscious, most Canadian companies are not necessarily in the vanguard of ethical business practices, although firms like HBC and Gildan Activewear stand out as having taken significant steps in employing socially responsible business practices.

Still, "most of the dialogue that is happening is in the U.S.," Chan says. "It's a surprise because Canada sees itself as being socially conscious. We're somewhat deluded. Canada tends to be just very happy to be in the middle ground."

Smith agrees, but adds that, while convenience, price and quality still hold sway, consumer attitudes are changing. Smith cites a study by public opinion researcher Globescan that shows "Canadian consumers are relatively more likely to punish a company based on social performance [than their peers]." However, "few people understand the complexity of the issues, and they do not understand what their dollars can do. Consumers tend to be clueless about the global industrial complex; even those who consider themselves engaged are not able to make a decision. So the onus is more on companies to make sure they do business with suppliers that comply with the law." ■

John Cooper is a Whitby, Ont.-based writer.

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