KPMG

Issue 6, Oct/Nov 10

Agenda

Insights into growth, performance and governance

China's Jack Welch
The secret genius of BYD founder Wang Chuanfu

Life after debt
Do governments know how to deal with deficits?

Green and black
Why sustainability can't be ignored – and how it can pay off

"When you're CEO, people only tell you what you want to hear"

How Novartis boss *Joe Jimenez* is focusing on the figures that matter

AUDIT ▪ TAX ▪ ADVISORY

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“Crisis, in its original Greek, refers to a time of change.

It seems an apt description for the current business climate, which is challenging many of our assumptions – including, perhaps, Professor Francis Fukuyama’s assertion, in his influential *The End of History and the Last Man*, that democratic capitalism would become the global default setting.

As governments wrestle with deficits and business debates the impact of new regulation, the status quo Professor Fukuyama describes has never seemed further away. Indeed, companies may like to consider how their outlook would change if our current political system didn’t prevail in the long term.

In this issue of *Agenda*, we explore many of the key challenges shaping the world, and also profile some of the business leaders finding ways to thrive through innovative thinking. They include Joe Jimenez of Novartis, who has rethought his business model to anticipate shifts in healthcare, and BYD founder Wang Chuanfu, who is building what he hopes will become the world’s biggest auto manufacturer from the ground up, challenging the prevailing wisdom of manufacturing processes too.

By thinking the unthinkable, and refusing to accept the way things are traditionally done, this time of crisis actually offers unprecedented opportunity for far-sighted companies.”

Alan Buckle
Global Head of Advisory, KPMG

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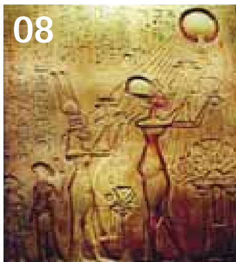
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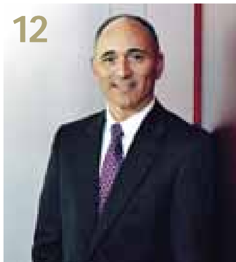
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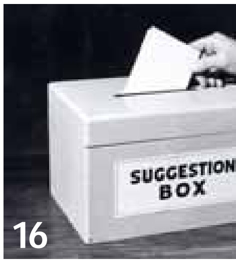

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Revolution, one BRIC at a time

A marriage made in Rio suggests emerging economies can challenge the established order

Has Brazil found a way to fast-track its fellow BRICs into positions of economic power? The country is beginning talks this year on a possible economic alignment with Latin American neighbor Mexico which would create the world's fifth-largest fiscal system.

"This is not just a free-trade agreement... We are going to try to bring the two economies together," says Brazil's foreign trade secretary Welber Barral, who expects bilateral trade between the Latin American partners to reach US$7bn (€5.4bn) this year. "We are talking about goods, but also about services, customs and public-sector procurement."

Mexican president Felipe Calderón says: "Growth will not come from the developed economies. It will come from emerging economies like China, Brazil, India and Mexico".

Despite suffering in the recession (80% of its exports go to the U.S.), Mexico remains an attractive destination for investment. Analysts predict 4.5% GDP growth this year, and the Mexican treasury expects the economy to create 625,000 jobs by year end. A recent KPMG study found it has the most competitive tax regime of ten leading countries.

Analysts say Brazilian GDP will rise 6% this year. Industrial production increased by 17.4% in the first quarter, and the car industry is tipped by analyst JD Power to overtake Germany's to become the world's fourth largest by the end of the year. Brazil has seven companies in the Fortune 500 to Mexico's two.

Though some forecasters are worried by Brazil's excessive growth, Chinese investment could take it even further. State Grid, China's biggest electrical utility, has paid US$1.7bn (€1.4bn) for seven electricity companies, while two businesses have invested US$5bn (€4.2bn) in Açu, a port described as a "highway to China".

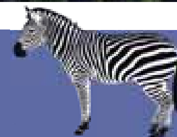
The Brazil-Mexico two-step and the China-ASEAN Free Trade Agreement (FTA) show the way forward for emerging economies. China's is the world's biggest FTA, with US$6trillion (€4.7trillion) of trade covering 1.9bn people. It will waive 90% of tariffs between China and its neighbors.

Though the U.S. is trying to revive a trade deal with South Korea, large economies have found agreement hard to come by since the Doha round of talks stalled in 2009. In their absence, Russia and Turkey have signed wide-ranging agreements, Canada has inked an export deal with Colombia, and New Zealand is negotiating with India. None yet has the scope and ambition of what could be a revolutionary deal between two major economies.

Brazil's car industry has quickly become one of the world's most important

Cassio Vasconcellos/Getty Images; Shutterstock

microtrend



Fast zebras

Want to encourage intrapreneurship without giving the green light to dangerous mavericks? Look for the fast zebras. Like their four-legged equivalents, these managers are dynamic, adaptable and able to sidestep predators, in the form of needless bureaucracy and group think. They focus on metrics and are aware of how the business can help them achieve their goals, using established hierachies and processes when required, while also relying on informal networks. Placing such individuals in key strategic roles could be a more effective way to drive change in a company than expensive programs.

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Come together

Joint ventures flourish in tough times

With M&A still cautiously recovering and uncertainty remaining over long-term investment, major companies are turning to a trusted old friend to deliver growth.

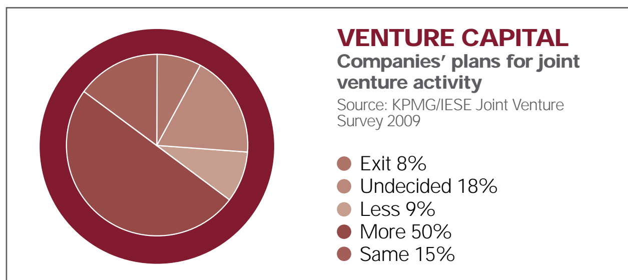
Joint ventures, recently popularized by the automotive industry, are finding favor in many sectors. Half of global companies plan to enter one in the next two years, according to the recent KPMG/IESE Joint Venture Survey.

France Telecom and Deutsche Telekom are the latest joint venturers, creating the biggest player in the UK mobile phone market in a deal aimed at achieving annual sales of US$13.5bn (€9.4bn) and eventual savings of around US$5.3bn (€4.2bn).

Daimler has joined the successful Renault-Nissan alliance aimed at cracking the nascent electric car market, in a move which analysts say aims to offset the prohibitive cost of developing the new technology required for green models.

KPMG research suggests gaining access to new markets is the main motivation for 60% of companies undertaking joint ventures – this is a higher priority than reducing costs. The desire to spread risk is foremost in CEOs' minds, according to Erik Lange, Partner, Transaction Services. But he says the detail is in the planning: "Joint ventures are supposed to be flexible, but sometimes they can be just the opposite. You'll only achieve synergies if you do the right level of work. In that respect, the issues that crop up aren't that different from acquiring a company."

Lange says deciding the aims of a joint venture, what will constitute success and how you will exit are key considerations. It's also helpful to get financial structures and reporting mechanisms in place before work gets underway. That way, a corporate marriage can end in wedded bliss rather than painful, costly recrimination.



VENTURE CAPITAL
Companies' plans for joint venture activity
Source: KPMG/IESE Joint Venture Survey 2009

Credit's open secret

The ethos behind open source software has caused Microsoft executives a few sleepless nights, and now this approach has a new target in its sights: credit ratings agencies. The agencies, which came under fire for failing to warn against bank collapses, have been forced to share algorithms by EU regulators.

That's caught the imagination of amateur financial modelers worldwide, who've been contributing their own ideas for better predicting companies' financial health. The website Freerisk (freerisk.org) acts as a home for their best efforts, but Aaron Brown, a former economics professor who now manages risk for hedge fund AQR, says that's only the start: "There are a lot of capable people who would welcome the chance to join a competition to develop a superior credit rating model."

leading edge

The most profitable business on the planet

Market forces can save the world from climate change, says Graciela Chichilnisky, creator and author of the Carbon Market of the Kyoto Protocol, author of *Saving Kyoto* and Professor of Economics and Statistics at Columbia University, New York

Businesses need to see the ROI in sustainability
Attempts to engage companies in resolving climate change have so far failed because they haven't shown companies genuine ROI in going green. The critical link is the energy industry: 41% of emissions originate in coal and oil power plants. We cannot solve climate change without changing the energy industry.

The public sector cannot save the world alone
Sustainability should be seen for what it is: the most profitable business on the planet. However, we need help from the carbon market, which creates a price for carbon that transforms the value of all goods and services on the planet, and which I designed and wrote into the Kyoto Protocol in 1997. Today, a solution can only be achieved by engaging the private sector, which can bring about funding for adaptation, mitigation and carbon reduction in developing nations. At the Copenhagen climate conference in 2009, the U.S. proposed a US$100bn (€77bn) fund based on my proposal to the U.S. Department of State and U.S. Treasury. I would go further, creating a US$200bn-(€154bn)-a-year fund that uses private as well as public funding. This can develop into a market-based solution benefiting both industrialized and developing nations.

Business must step up its efforts
My model is straightforward: heavily industrialized nations would underwrite a fund, contributing already-pledged amounts from Copenhagen – around US$10-25bn (€8-19bn) – to cover the riskiest slice of the fund. The second riskiest slice would be covered from pension funds in industrialized nations, which are required to green their portfolios. The rest would come from global capital markets. The energy industry in the OECD will contribute technology and training, and should support the effort in legislative circles. Bankers have already expressed interest.

New economies create new opportunities
How will the money be spent? Energy demand is rapidly increasing, especially from developing nations. The energy industry is aware of the opportunity this creates, yet lack of funding can be a problem. This can be resolved by building "green" power plants – that co-generate electricity with carbon capture from the atmosphere – with funding provided by the carbon market and its Clean Development Mechanism (CDM).

A win-win solution for the world economy
The technology behind green power was advocated by Dr. Rajenda Pachauri, chair of the Intergovernmental Panel on Climate Change (IPCC), who says "sucking carbon from air" is necessary to avert catastrophic climate change. Much will be decided in the next few months – and as the U.S. offer is fleshed out, business objectives and global imperatives will steer the equation towards green energy. Only the future will tell whether the international community makes the most of this opportunity.

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What's on their 'to do' list?

These leaders run five very different organizations but share one big challenge: making sure they – and their agendas – are trusted by investors, customers and governments

01 DOMINIQUE STRAUSS-KAHN

61, managing director, IMF

The financial crisis put the International Monetary Fund (IMF) at the forefront of regulation. But firefighter-in-chief Dominique Strauss-Kahn's trickiest battles may be yet to come.

The story so far Formed in 1944, the IMF was once dubbed the 'International Monetarist Fund' by critics who believed it inflicted a one-size-fits-all model on debtor nations. But global recession prompted a tripling of funds – it now has US$750bn (€587bn) available – and it intervened in Iceland, eastern Europe and Greece, where it contributed US$38bn (€30bn) in funding over three years. Suave former French Finance Minister Strauss-Kahn, appointed in 2007, now scoffs at pre-recession doubters: "It was like wondering about the need for firefighters when you don't have a fire."

What's next? Strauss-Kahn, known as DSK, wants the IMF to be less reactive, and told economists: "We need a new toolkit." That includes another US$250bn (€196bn), which it will make available as flexible credit lines, to discourage hoarding. He also plans to "proactively channel liquidity to countries under pressure." A global bank tax, which he favors, isn't off the agenda, and liquidity rules could be loosened to counter critics who say Greek intervention took too long. But Strauss-Kahn might not be around to handle such issues: he is tipped to contest the French presidency in 2012.

He'll succeed if… A move to a more activist approach is backed by stakeholders. History judges recent IMF interventions to have staved off long-term crisis. His successor isn't a retired politician or faceless apparatchik.

02 URSULA BURNS

51, chairman and CEO, Xerox

Her predecessor revived the global document management giant. Can Ursula Burns complete Xerox's transformation?

The story so far Once such a dominant player its name became a verb, Xerox's decline in the 1990s is a textbook example of falling behind in technology. With the web undermining print and paper, and low-cost imports a threat, then CEO Anne Mulcahy honed product lines, transformed corporate culture and introduced a software arm. Revenue reached US$17.2bn (€14.4bn) in 2007, defying commentators, but the recession hit Xerox hard, as SMEs spent less; it shed 5% of its workforce in 2008. Noted for her humor and candor, Burns joined as an intern in 1980 and took over the top job in 2009, the first female African-American CEO in the Fortune 500.

What's next? Revenue of US$4.7bn (€3.9bn) in Q1 2010 was up 33% year on year. "It's all about growth," Burns said after completing the US$6.4bn (€5.2bn) acquisition of Affiliated Computer Services (ACS). The deal made Xerox a major player in IT consulting, head-to-head with IBM, HP and Dell as an outsourcer. On Burns's watch, Xerox's overseas revenue has eclipsed North America for the first time.

She'll succeed if… ACS can be profitably integrated into Xerox and deliver value for shareholders. Potential customers trust Xerox's consulting skills as much as IBM's or HP's. Investors trust that she can maintain Xerox's growth in emerging markets.

Go further

www.imf.org
www.xerox.com
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03 HELGE LUND

47, CEO, Statoil

The entire energy industry has been worried by recent negative publicity and Statoil, the largest offshore oil and gas producer in the world, headed by Helge Lund, has cause for concern.

The story so far A former McKinsey consultant and a past adviser to Norway's Conservative Party, Lund was brought in from Norwegian engineering and construction firm Aker Kvaerner in August 2004 to clean up Statoil after it was found to have paid bribes to Iranian officials. After asking his executive committee to beef up Statoil's ethics code, Lund has overseen a series of astute acquisitions. The Norwegian energy giant – 67% owned by the state – began life in 2007, when Statoil merged with the oil and energy activities of 105-year-old aluminum company Norsk Hydro. Net profit trebled to US$1.8bn (€1.5bn) for Q1 2010, a healthy return for Statoil, which has operations in 40 countries including around 80% of Norway's oil and gas production.

What's next? As a pioneer in carbon capture and storage, Lund believes Statoil can be at the forefront of the industry's cleanup campaign. "In the competition between energy companies, one of the competitive arenas is how you respond to climate policy," he says. Statoil is "intensifying its procedures" to ensure there is no future safety scare. The Peregrino field in Brazil's Campos Basin, which should begin production in 2011, could eventually produce up to 100,000 barrels per day.

He'll succeed if… Investors don't shun offshore drillers. North American expansion plans prove cost-effective. Safety remains a paramount concern.

04 CHAI PATEL

55, chairman, Elysian Capital

British healthcare entrepreneur Chai Patel is the man hoping to lead private equity's rebound.

The story so far Founded two years ago by chairman Patel and chief executive Ken Terry, private equity firm Elysian announced the final closing of its fund in September 2010 at US$200m (€157m). This is the biggest debut UK buy-out fund since the sector began to suffer in late 2008. Patel is best known as the serial entrepreneur whose acquisition-based strategy turned Court Cavendish into a market-leading healthcare provider and developed the Priory Group, which runs a well-known rehab clinic favored by celebrities, as well as educational services and psychiatric hospitals.

What's next? Patel is targeting a dozen ventures in the UK, and has managed to buck recent trends. The *Financial Times* says 18 British PE funds raised a total of US$8.9bn (€7.3bn) in 2009, down from 55 funds generating US$14.2bn (€11.6bn) in 2008. In the U.S., fundraising fell 65% over the same period. Elysian counts park maintenance and pharmaceutical companies in its expanding portfolio.

He'll succeed if… He uses his healthcare expertise shrewdly to select ventures. The private equity rebound in Europe gathers pace. Elysian's portfolio is diverse enough to side-step turbulence in individual sectors.

05 PRANAB MUKHERJEE

74, Indian minister of finance

Praised by commentators for his cautious modernization of India's economy, the country's finance minister must convince a skeptical business community his reforms won't hinder progress and that he can control India's deficit.

The story so far A member of India's political class since the late 1960s, this is Pranab Mukherjee's second term as finance minister. Since his return in 2009, the University of Calcutta graduate has channeled funding into social and infrastructure schemes, from healthcare reform to expanding electricity coverage. His biggest problem is persuading people that India can afford his careful modernization.

What's next? National debt stands at 5.5% of GDP, while inflation rose to a 17-month high of 9.9% in April 2010, as food prices became a major political issue. Securing foreign investment remains critical to Mukherjee's plans, but the OECD labeled India's lawmakers "restrictive" in 2009. Mukherjee agrees: "Procedural simplification will facilitate foreign direct investments." Reforming the laws on retail investment could radically alter the economy – Wal-Mart and Carrefour are keen to invest but can currently only act as wholesalers. Left-wing parties oppose liberalizing markets, arguing that strict controls helped buffer India against recession. But if he is to achieve his goal of 9% GDP growth by 2013, he can't slacken the pace of modernization.

He'll succeed if… He can bring the fiscal deficit down to 4.1% of GDP and make India an easier place to do business in. That isn't just about abolishing red tape: Mukherjee needs to invest US$1 trillion (€811bn) on infrastructure. Reform progresses in a tricky political climate. Multinationals don't turn to other BRICs or emerging markets.

Stephen Jaffe/International Monetary Fund, Press Association

> "In the competition between energy companies, one of the competitive arenas is how you respond to climate policy"

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Why change management is the core competence

In the 21st century, no business can flourish unless it can continuously adapt. Yet seven out of 10 transformation projects fail. These six factors could improve your chances of success

BY STEPHANIE OVERBY

The concept of change has become so powerful that it elects politicians – and so pervasive that no business leader could impress investors by extolling the virtues of the status quo. Yet while driving change is a constant preoccupation for most CEOs, relatively few change management programs succeed. Most experts agree that around 70% of change in multinationals fails, a figure that has remained pretty constant for the past 15 years.

"Corporations have been asked to take on change in the past," says Mark Spears, Global Leader in KPMG's People and Change practice. "But now they're taking on lots and lots of change all at the same time." Government regulation, globalization, emerging technology, environmental responsibility, increased competition, economic uncertainty… "There are all kinds of drivers forcing organizations to react and evolve," Spears says.

Major strategic shifts now come around much quicker. "Many companies are being hit with those big changes that, not too long ago, happened once in a decade, in half or a third of that time," says John Kotter, the Konosuke Matsushita Professor of Leadership, Emeritus, at Harvard Business School and author of *Buy-In: Saving Your Good Ideas from Being Shot Down*. "The consequences, the stakes and the costs of change management failure are big."

Change hurts. Organizations are structured to resist it. People are hard-wired to reject it. "People have a view of the world. They see it through a frame of reference," says Spears. "If you challenge that, they fight against it." Today, staff are being asked to take on three to four times as much change as they can naturally handle, he suggests.

Yet, as Edward E. Lawler III and Chris Worley

Amenhotep IV's attempt to introduce a new religion in Egypt was a top-down initiative that stalled as soon as the leadership changed

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Paul Schemm/AP/Press Association, The Bridgeman Art Library; Pictorial Press/Alamy

argue in *Built to Change*, the ultimate corporate advantage in today's business environment is the ability to transform, making change management the definitive core competence. Change is seen by many as a positive force, an opportunity to reassess the fundamentals and keep excesses in check. It can be so useful that one CEO even quipped: "In some companies, if you don't have a crisis, you should make one up."

It's easy – if time-consuming – to list all the steps that characterize successful change management efforts. Having the discipline to stick to them is the hard part. "Even if you get all of these things right, it's still a bloody and difficult process. And that's just one change," Spears warns. "But companies today have to become change-capable. It's too costly not to get it right."

1 Persuade the troops

The logical first step to major change is convincing everyone that a fundamental shift is needed – and quickly. But rather than hitting employees over the head ("A little hit on the head does wake people up, but hitting them on the head 19 times will kill them," Kotter says), leaders must ignite the kind of fire that inspires deep-seated, durable change.

> "A little hit on the head wakes people up. Hitting them on the head 19 times will kill them"

It is essential that change is driven and communicated by senior leaders. When Jeffrey Hiatt and Timothy Creasey, authors of *Change Management: The People Side of Change*, explored failed change management initiatives, they found there often wasn't enough communication from executive sponsors and senior managers.

Change is easier when company culture is prepared for upheaval. In the 1980s, says former AlliedSignal CEO Lawrence Bossidy, change was "a radical, unpopularized idea" akin to "changing the tire when the car is running" at many multinationals. By the time Bossidy was implementing his own changes at the aerospace company in the 1990s, however, "the burning platform was obvious to everyone".

Hugh Grant, CEO of Monsanto, took this lesson on board when he began its transformation from an agri-chemical company to a biotech giant. He was quick to personally engage colleagues at all levels of the company, regularly addressing meetings to explain his vision and answer questions. Lawler says: "Monsanto's history until Grant became CEO was one of episodic mega-changes. It wasn't terribly successful… Under his leadership, Monsanto transformed itself into a business that's built to change."

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Go further

John Kotter's change model
www.mindtools.com/pages/article/newPPM_82.htm

Leading Change **(1996)** by John Kotter (Harvard Business Press)

But bravery is often rewarded. Intel restructured to abandon dynamic RAM, the invention which had made its name, and carve out a more profitable niche in the then-nascent microprocessor market. Such extremes may not suit every company, but change represents an opportunity to radically revisit tried and tested systems.

2 Too many cooks can be useful

A common problem plaguing change management efforts is that too few people are invited to the strategy party. "We don't involve people in change nearly enough," says Spears. "You need to get people to own the change instead of having the change done to them. Then they react more positively to challenges."

Once the top executives are in agreement – an important step in itself – the next task is to recruit a broader group to the effort. "In every company, a small group of stakeholders lays claim to most of the influence," says Kotter. "Unless a change agent rallies these key decision-makers to their side, they will have difficulty garnering enough momentum to shift the organization."

Kotter suggests that ideally the change forum should include around 35 people. But how do you figure out who to include? Ask. "The people who come screaming, 'Put me in! Put me in!' will be attentive, cooperative, and sensible," he says.

But don't let the same group drive every change. They will burn out, and may not be the best advocates for every new plan. Be sure to give the group authority and visibility. "Don't dump this on a task force buried in the organization," says Kotter. Be clear about how much involvement is required and what the goals of the coalition are.

"After a few successes, some CEOs declare victory and move on. They don't make it stick"

"You have to be clear about the benefit of what you're moving toward," says Spears. "And it has to be meaningful." If you're going through a merger, for example, just talking about synergies fails to inspire. Kotter says a smart leader will focus and simplify their vision until they can articulate it to a group in five minutes or less. When Alan Mulally took over as CEO of Ford in 2006, he imagined a future in which regional and business unit fiefdoms within the automaker united to produce global cars for global consumption. He honed his plan for change down to two words: "One Ford".

3 It's the quality – not quantity – of information that really counts

Most managers say they understand the power of communication – yet are very bad at it. "We're taught that communication means creating a PowerPoint, giving that message to a comms person and cascading it down the organization," Kotter says. "You end up pouring 10,000 gallons of information on the people below you. That's not a good way to make things happen."

Having a concise mission statement is handy. Most leaders live in fear of repeating themselves. But when it comes to change, reverberation is compelling. "Leaders should be more afraid of [staff] misinterpreting the vision or losing sight of it," Kotter says. "Just because you've said it before doesn't mean people six layers below you have heard it. They've got 5,000 things to worry about and you spent an hour on it one time. It gets lost."

Corporations that are built to embrace change make sure that two-way communication becomes part of their culture, say Lawler and Worley, as IBM has done with its famous 'jam sessions'.

Face-to-face communication – or some approximation of it – is the best way to connect. "The people most affected by change need to figure out how to adjust their frame of reference," says Spears. "They're going to have questions and you have to be there answering them."

Buttress that with packets of information, emails, stories in the corporate newsletter, change portals. The level of detail must be appropriate to the audience. "Identify key constituencies and understand that each has different communication needs," advises Spears. "If you're introducing a new suite of IT systems, there may be no fundamental impact for large groups; updates may work fine for them. Those whose roles will change or disappear need more details on rationale and how they fit into the future state of things."

Creasey points out that change can mean different things for different constituencies. While executives ask about the impact on customers, the level of investment and the ROI, staff on the front-line may have more fundamental questions: "Will I still have a job? And do I have the skills and knowledge to succeed in the new environment?"

No matter how eloquent you are, you won't convince everybody. But rather than marginalize sceptics, you might want to engage with them. Sometimes, an open dialogue can yield pearls of insight which will help you achieve change.

4 With change comes opportunity

To embrace change, an employee must be willing – and able. "A company may spend millions on a merger or acquisition," says Spears, "and then spend only a fraction of that on training."

Customization is key here. "It can't be a sheep dip, with everyone going through the same training," says Spears. "You must have a clear understanding of the new competencies required and tailor your training efforts so people are fit for the new purpose."

With transformative change, the new skills are often more behavioral than technical. An employee whose IT role has been outsourced may be willing to take a stab at the more strategic job of business

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Agents of change

Peter The Great
The great 17th-century tsar founded Russia's navy, modernized its customs (taxing aristocrats who wore beards) and created a new capital, St Petersburg, known as the "city of bones" because so many slaves died building it.

Franklin D. Roosevelt
The new president's first 100 days in 1933 set new records for the number of new bills passed. Such activism was justified by the Great Depression. By selling change as a New Deal for every American, Roosevelt (below) paved the way for a landslide victory at the polls in 1936.

ITT
Under charismatic chairman Harold Geneen, the sleepy industrial company acquired 250 firms in 18 years, achieving annual profits of US$550m (€428m) by the late 1970s. But as market and public sentiment moved against giant conglomerates, ITT failed to react and by 1995 was broken up.

Amenhotep IV
As ruler of Egypt in the 14th century BC, he made Atenism the new, principal religion. But the public hated the enforced faith, jettisoning it within a decade of his death. His son, Tutankhamun, had to repudiate the new religion to become pharaoh.

Peter the Great's brutal, enduring change helped make Russia a great power

liaison, but lack the capabilities. That kind of shift takes time and in-depth education.

Others may have been won over by the urgency, vision and communication, but instinctively cling to the old way of doing things. Recognition and reward programs need to be retrofitted to the revolution in roles. To change the focus at GE from quality, costs, and deals to revenue-generating innovation, CEO Jeff Immelt tied bonuses to idea generation. At the privately owned technology and fabrics company W.L. Gore, organizational charts and job titles are rare because the company believes they hamper collaboration and innovation.

5 Focus on the numbers

The forces of tradition in an organization are always stronger than a proposed change. It's helpful to break down the transformation into smaller chunks of changes so the organization can monitor and celebrate success. "The scale of a change can be overwhelming," says Kotter. "Whittle it down into bite-sized bits, and be sure to celebrate every milestone. Build on small, short-term victories to infuse the team with momentum so they can carry out the full extent of the desired changes."

"You launch a big change with massive fanfare – we're going to merge with this business, transform this function," says Spears. "But you have to measure progress against goals to demonstrate momentum. You can't just assume you're achieving them. You have to measure them and celebrate them." And you have to ensure that you're measuring the right things, the indicators that prove you're enhacing the value of the business,

It's a mistake to let up too early. Often, "a new CEO gets something going and, after a number of successes, they declare victory and move on," says Kotter. "They don't worry about making it stick." Many things can sidetrack a change effort – the abrupt departure of a CEO, a shift in the economy, or massive growth. "Social anthropologists have proven that the ultimate glue is culture," Kotter says. "If you can connect change to the culture, it doesn't just ramble off when winds pick up."

There's no magic to all this, says Spears. To get through the first weeks, months, even years, of transformation, a leader needs to rinse, wash and repeat the steps to serious change – rallying the troops, keeping an eye on key indicators, updating and communicating the vision, and making sure that employees can continue to contribute.

6 Feel the fear – and use it

Many management experts advise sugar-coating bad news, but there is always a point where truth is the most powerful weapon. For Om Prakash Bhatt, that point arrived soon after his appointment as chairman of the State Bank of India (SBI), the country's oldest bank, in 2006. The bank had lost 20% of its market, and its leadership position. Bhatt took 25 of its top leaders on a five-day retreat. He showed them *The Legend of Bagger Vance* – about a golfer who loses his swing – and likened the predicament to SBI's market slide.

And then the stick came out. "Before, we were always told everything was hunky-dory, but I wanted to be brutally honest," Bhatt says. He laid it on the line: the bank faced extinction if it didn't change. "When a company tries to hoodwink itself, everybody becomes a partner to institutionalized hypocrisy, which is what had happened here," he says. The leaders left with a 14-point action plan setting out the fundamental changes they needed to make. The harsh truth lesson worked: SBI regained its leadership position in India, and entered the Fortune 500 in 2008.

Sometimes, when change is the key to survival, honesty is the only policy.

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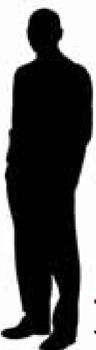
"The best advice I've been given is not to take a linear career path"

Novartis CEO Joe Jimenez hardly took the easy route to the top of the global healthcare company. But will his FMCG background prove invaluable in an industry that must reinvent its business model?

BY PAUL SIMPSON



...did you know?

Jimenez was captain of his swimming team at Stanford University

Joe Jimenez only became CEO of Novartis in February 2010 but he is already acutely aware of one of the job's pitfalls: "Everybody tells you what you want to hear. It can be isolating. You have to be sure you reach out and engage with people."

For Jimenez, engagement comes in many forms: lunchtime talks with different Novartis associates of all levels, a development program with some of the group's managers learning the wisdom of Harvard Business School, and a blog on the Novartis intranet. He started blogging in 2008, shortly after he was asked to run the pharmaceutical division, and continues to write new posts every week. Many CEOs might regard such activity as pointless or distracting, but Jimenez explains: "I have 100,000 employees in over 140 countries and had no way of communicating with them all. I was hesitant at first. If I started the blog and there was no interaction I wouldn't accomplish anything." But he decided to devote some Sunday evenings to the blog. "And then I wait a few days, look at the responses and then respond to them."

There is nothing evangelical about Jimenez's interest in social media (he's a blogger but no Twitterer). It seems to him a matter of common sense: "Social media is one very important way to frequently interact with employees. People have flocked to it. And through the use of online forums like ideapharm [see page 15], it gives an organization of this size – we employ about 100,000 people globally – a mechanism for moving good ideas around the company far faster than we have been able to historically."

It is that kind of pragmatism, unfettered by industry or corporate tradition, that made him, in the words of one analyst, a "surprising but logical" choice to run Novartis. But, leaning over the table in a rather nondescript meeting room in the company's spacious campus in Basel, Switzerland, he is honest enough to admit he hasn't always been as open to the unexpected.

Graduating from the University of California Berkeley with an MBA in 1984, Jimenez was determined to make his name in the fast-moving consumer goods (FMCG) market. Already, he was thinking several moves ahead. "It was a very strong training ground," he says. "If you succeed in FMCG, you learn how to analyze a business's strengths and weaknesses, take action based on that analysis and act quickly."

After learning how to launch and market consumer goods at the likes of H.J. Heinz, he rose swiftly until his career almost took a wrong turn. "In one company I was running a large business and the next step I was offered was to run a start-up. I said: 'Forget it. Going from a US$300m business to a US$10m business – that's a demotion'." But one of his mentors at the company advised him: "Do not take a linear career path".

Jimenez wasn't convinced but reconsidered as his mentor described the "massive amount of

Elisabeth Real

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Six lessons from Novartis

1 Innovation should be the responsibility of every individual.

2 Don't think and act like a conglomerate. Organize your business into focused units that understand and drive their markets.

3 But don't be too focused. Sensible diversification – into generics, eyecare, diagnostics, over-the-counter drugs – has reduced the company's exposure to the global squeeze on state healthcare budgets.

4 Decluttering your business is vital. Many companies' processes become overly complex over time. A fresh appraisal can speed decision-making, save money and free up cash to fund innovation.

5 Rethink your business model. Traditionally, pharmaceutical companies looked to single drugs with a massive patient pool to drive revenues. Novartis focuses on disease mechanisms where more than one patient group may benefit from a new compound in the long run. The initial market may look smaller, but the reward may prove as great.

6 You can harness the power of social media to drive innovation, especially in a large, global group.

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experience" he would miss out on if he said no. Innovation, new products, how to start a business from scratch – this was the kind of expertise he would never acquire if he followed the shortest, straightest route to the top. He admits now with a wry smile: "Even though I'd resisted it, it turned out to be the best advice I've ever been given."

Cost isn't king

When Novartis management invited him to run the consumer health division in 2007, his decision was much easier. He went on to lead the pharmaceutical division – the third largest pharma company in the world by sales. As captain of his swimming team at Stanford University, Jimenez used to tell exhausted teammates: "Sometimes, the only way out is through". He may have reflected on that advice in his new role: "I had to spend a lot of time learning the science," he admits. "That was a steep, steep learning curve, 24/7 for 12 months. In comparison, moving up to CEO was easier."

> "Social media gives us a mechanism for moving good ideas around the company faster"

Chairman Daniel Vasella, who promoted Jimenez, has consistently looked beyond the traditional pharma talent pool: new CFO Jonathan Symonds, for example, is from Goldman Sachs.

As the new CEO, Jimenez, 50, set three goals: extending the company's lead in innovation, turning innovation into growth and driving productivity to improve margins. His appointment was interpreted as evidence of a new focus on cost, but Jimenez's approach has been more strategic. The goal isn't just to save money but to accelerate decision-making. The ruling executive committee shrank from 12 to nine. Sub-committees that traditionally vetted proposals before they reached the executive committee were abolished. It sounds a small change, but Jimenez says: "Being scrutinized by these sub-committees could sometimes delay a project by a month or two.

"Novartis is a science-based organization with a long new product development timetable and a lot of analysis going into decision-making. That is absolutely right for decisions about science. But we were applying the same analysis and timelines to decisions in sales, marketing and finance."

Paradoxically, by using too many performance indicators, Novartis Pharma struggled to accurately measure its performance. There are fewer metrics now. Jimenez stresses that the lifeblood of a business like Novartis is innovation. That can be partly measured by the volume of new products and the revenues they deliver. In 2009, Novartis won 30 major regulatory approvals and drugs launched since 2007 generated US$4.7bn (€3.6bn) in revenue.

Because Jimenez can't remember the industry's golden days, the early 1990s when the regulators approved almost any drug and every new launch – even a me-too compound – generated a fat margin, he has been able to ask 'why' a lot at Novartis. Often, the justification for a decision or a process makes perfect sense. If the answer is "Because we've always done it that way," he has not been afraid to initiate change. For example, when he took over the pharmaceutical division, suppliers competitively bid for only 4% of contracts. That total has risen to around 25%. In FMCG, it was typically around 75%.

"We're just getting started. Many of our processes are too complex. Budgeting is almost a nine-month process which means we're nearly in a perpetual state of budgeting." He stops himself at this point and says: "Here I am talking about the negatives, when there are so many positives."

One positive, he says, is that the drive for decluttering and productivity has helped fund innovation. "We have one of the best pipelines of products in the industry. And I'm maintaining my R&D spend at a time when many of my peers are cutting theirs because they're not getting value out of it."

Eyes on the prize

When asked if a particular theory of management, thinker or book has influenced him, Jimenez takes a few seconds to collect his thoughts and leans forward: "I'm a big believer in the principle of focus. If you can focus people on a certain type of business – for example, having one division in generics, another in pharmaceuticals – and let the right people drive it you can get incredible results." This approach, he suggests, delivers a better performance

Jimenez says the blockbuster drug isn't dead, but the focus is on disease mechanisms not sheer sales muscle

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Making the web work

Under Joe Jimenez's guidance, Novartis has become a market leader in using social media as an engagement tool.

Intensive farming
Ideapharm is an online community where employees can post ideas that have worked for their business and may prove useful to other units.

Community action
Novartis has become involved with two communities at PatientsLikeMe, a site where patients help each other manage conditions. The company used the community to recruit patients with MS for clinical trials, and also began working with organ transplant recipients.

Video stars
The company used a YouTube channel to promote the launch of a new pain relief drug in the U.S. It developed a contest which soon spread virally to Facebook. One contestant's blog drove 20,000 people to the YouTube channel for Excedrin.

Apps in focus
Business unit CIBA Vision has launched a free iPhone app for eyecare professionals. Novartis Vaccines & Diagnostics is behind VaxTrak, an app aimed at families who want to keep track of vaccination schedules.

than diffuse different businesses working in one big conglomerate. Novartis divisions focus on discrete markets but the group's long-term strategy, Jimenez says, is for "focused diversification".

In February 2005, Novartis bought two generic drug businesses for around US$8.3bn (€6.4bn). This strategic move is delivering strong results, Jimenez says: "Focused diversification has helped make Novartis the best placed company in the healthcare industry, especially when you compare us to pure-play pharma groups. We're innovative in pharmaceuticals, but our generics business, the second largest in the world, is flourishing."

Focused diversification has come into its own since the financial crisis because, he says: "This means that less than 60% of our product line is reimbursed by public partners, whereas with a pure play pharma that exposure might rise to 80-90%. We've had price cuts – 20% on all pharmaceuticals in Greece, for example – but we're somewhat insulated against the effects of the cost containment. And we're working with debt-strapped governments to develop innovative pricing mechanisms so we can work within their budgets to meet patient needs."

Morose prognostications about government healthcare budgets have, he feels, tended to obscure the basic truth about healthcare: "In the long term, this is a growth industry. The global population is ageing and there are unmet needs which drive demand for the development of innovative new products."

Playing the long game

Jimenez is equally unimpressed by the conventional wisdom that the days of the blockbuster drug are gone. "The blockbuster drug is still with us, but the focus is on the science and pathways that may be shared in several disease areas. The old definition of a blockbuster drug was to find a therapy area with a big patient pool, find a compound that's incrementally better than something that's already on the market and use your sales and marketing muscle to make sure you were instantly reimbursed. "Now we're focusing on disease mechanisms. Interleukin 1, for example, is a molecular pathway active in many diseases, and we've developed a drug, Ilaris, for patients with CAPS [cryopyrin-associated periodic syndrome, a rare, life-long auto-inflammatory disease]. By itself, that community of patients may be rather small and not a large business. But Interleukin 1 is active in diseases like gout, which affects three million people in the U.S. alone." If the company's R&D strategy is right, it could develop compounds to attack disease after disease associated with a particular pathway.

His conviction that strong sales of generics will soften the blow as some of the most popular branded drugs lose their patents will be tested next year when protection expires for blood pressure drug Diovan, which generates annual revenues of almost US$6bn (€4.7bn). Before then, his greatest opportunity is completing the takeover of eyecare specialist Alcon.

Reminded that studies show as many as 70% of acquisitions don't deliver value for shareholders, Jimenez says success is all about strategic rationale and excellent implementation. "Some acquisitions – we've seen them in this industry – have been about cost synergies. Our synergies with Alcon are about developing an even stronger leadership platform. The management team have done a fantastic job in eyecare. They are very strong in the U.S. but we can help them in emerging markets. They can tap into our R&D strength in ophthalmology. That combination will help further enhance our innovation power and help ensure greater success for the patients we're serving."

The sums involved aren't small – buying 77.5% of the eyecare group will cost US$38.5bn (€29.6bn) – but Jimenez says: "This is a reasonable price for a business of this scale and market position."

With first-half results due to be announced tomorrow (sales grew 18%), Jimenez is on a tight schedule. As he's been candid enough to reveal the best advice he ever received, I ask him for his advice for CEOs of the future. He doesn't hesitate: "Make sure you take responsibility for your own career. It should be 90% your responsibility and 10% the company's. Don't wait for the company to tell you what to do next. Identify the experiences you need and seek them out." That way, you should recognize the perfect opportunity in whatever guise it presents itself. ●

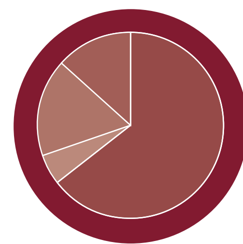
Find out more

The Determinants of M&A Success KPMG's guide to making deals deliver. For a free copy, email **agenda@kpmg.com**.

NOVARTIS IN NUMBERS

How the pharmaceutical giant achieved US$44bn sales in 2009

Source: Novartis



Revenue in US$bn

- Pharmaceuticals 28.5
- Sandoz (generics) 7.5
- Consumer health 5.8
- Vaccines and diagnostics 2.4

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THE GOOD NEWS ABOUT DEFICITS

The price of pain: riot police clash with protestors in Athens in May as the Greek government cuts to avert fiscal meltdown

Aris Messinis AFP/Getty Images

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BY PAUL SIMPSON

As governments confront truly daunting budget challenges, there are models from the recent past that could balance the books and don't involve political suicide

Any finance minister trying to bring their deficit under control is urged not to make the same mistakes as Japan in the early 1990s. Unfortunately, few analysts agree about what those mistakes were. Keynesians have long argued that the Japanese government was too slow to stimulate the economy. Yet Richard Whittall, a Japanese fund manager for 20 years, noted recently: "I have witnessed numerous attempts by the Japanese government to reflate the economy through massive fiscal packages. The result has been zero nominal growth in GNP since 1990 and debt-to-GDP rising from 50% to 200%." Whittall concedes the stimulus may have saved Japan from a hard landing in the mid-1990s but says such harsh medicine in the UK in 1979 and Korea in 1997 was the catalyst for unparalleled growth in those countries.

Sir Roger Douglas faced this dilemma as finance minister of New Zealand in 1984. Economic growth was stagnant, inflation 1.5 times the OECD average, public spending accounted for 39% of GDP and the cost of servicing the public debt was 20% of GDP. Although in a left-of-center Labour government, he introduced a series of monetarist, neoliberal reforms, soon dubbed 'Rogernomics'. These included cutting agricultural subsidies, regulation and barriers to trade and capital, floating the NZ dollar, privatizing public assets and redefining the role of the state.

Controversy rages over how effective his reforms were, but the OECD concluded they produced real productivity growth which helped offset the geographic remoteness, small domestic market and difficulty of accessing world markets that always hamper the New Zealand economy.

Share the pain

Sir Roger advises governments to be comprehensive. "There is no point reforming the goods market, unless you're also reforming capital, labor and the government. Define your objectives clearly and move towards them in quantum leaps, otherwise the interest groups will have time to mobilize and drag you down. In a crisis, voters will accept cuts if they are clearly explained and they feel everyone is sharing the pain. If you take a subsidy from a farmer, he needs to see other sectors are paying the price too."

And that pain, he argues, must be felt by government: "It is impossible to construct an efficient economic process if the largest player in the economy is inefficient." So, government functions in New Zealand were privatized (but in such a way that there would be open competition, not just a monopolistic private business): civil servants were hired on five-year contracts and judged on the quality of their outputs; and the accounting system was changed so it was easier to tell what the state was buying and what outputs those inputs produced. The scale of change was startling. As Sir Roger recalls: "For example, in railways we went from employing 22,000 to 4,500 and carried more freight at a lower rate.

"There will always be a time-lag before the benefits of your actions come through, so the sooner you start the better. Economic corrections of this kind can take anything from six to eight years." With many governments facing re-election in five, that is a tough timescale for politicians. The scale and speed of Sir Roger's reforms may even have been

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> "If more than 30% of the savings come from tax increases it can damage economic growth. The pain should be felt through cuts, not taxes"

driven by his fear he might not win a second term. (Labour did, in 1987, but lost in 1990 after rows over the reforms split the party.) He is not swayed by the idea that deep cuts in public spending hurt consumer confidence. "People aren't stupid. A huge deficit, if it isn't dealt with, hurts confidence too – especially if you are locked into heavier interest payments just to manage the debt. What worries people isn't cuts, it's uncertainty."

Redefine the role of the state

His advice to finance ministers today is: "Don't blink. Every time we made a quality decision in the best interest of our country and implemented it, the problems went away. With quality decisions the costs are always upfront and easily seen. But the benefits take time and are not always quite so clear. I can show you how we lost 18,000 jobs in the railways, but I can't point out precisely where the 100,000 new jobs came from."

New Zealand's Labour government redefined the role of the state. Sir Roger believes "People can spend their money better than the government can. The government's role is to ensure there is plenty of competition so you have an open marketplace." Enduring fiscal gains were made, with government spending down from 44% of GDP in 1991 to 33% by 1999. The cost of servicing public debt plummeted from 20% to 10% of GDP.

Historically, most governments saddled with vast debt burdens have removed them by default, devaluation or war, but Alan Downey, KPMG's Head of Public Sector, says several countries have overcome such challenges: "The key message is that addressing deficits of this size is achievable. It has been done in Canada, Denmark, Ireland and Sweden. What is unusual now is that so many countries are trying to do it at once and doing it at a time when global economic growth is fragile."

Debate over various models of recovery is, Downey suggests, slightly misleading. A study by consultants Oxford Economics, commissioned by KPMG, shows that many of the models – whether they are from Canada, New Zealand or Sweden – have a lot in common: "First, addressing the deficit is a question of when, not whether. They need to use the crisis to create a national consensus for action. The bulk of the pain should be felt through cuts in expenditure, not increases in taxes. There is evidence that if more than 30% of the savings come from tax rises it can have a negative impact on economic growth. And governments should focus on cutting current spending, not capital spending, because that can be damaging."

Target public spending – and productivity

Government spending, says Downey, is key: "Western economies have typically shrunk to the level they were five or six years ago yet public

Public figures

Leaders who've grappled with deficits (clockwise from top right): UK chancellor George Osborne; former New Zealand finance minister Sir Roger Douglas; Japanese prime minister Naoto Kan; and former Canadian prime minister Jean Chrétien

Austerity in numbers

90%
the point at which the public debt-to-GDP ratio threatens economic growth

2%
of GDP accounted for by government spending in advanced G-20 countries

6%
of GDP: the maximum amount of revenue the IMF believes could be raised through extra indirect taxes in G-7 countries

12%
the shift in structural GDP required to reduce the U.S.'s public debt-to-GDP ratio by 60% by 2030

1%
the percentage of Germany's GDP accounted for by tax breaks and subsidies

51.3%
of GDP accounted for by public spending in Sweden, compared to the G-20 average of 37.7%

80%
of fiscal reduction revenues that have, the OECD estimates, typically been generated by spending cuts

16%
– the amount of GDP accounted for by VAT in Denmark

30%
of U.S. GDP accounted by taxation: the average figure in advanced G-20 countries is 42%

30%
– UK government healthcare costs that could be saved if all hospitals performed as well as the top 25%

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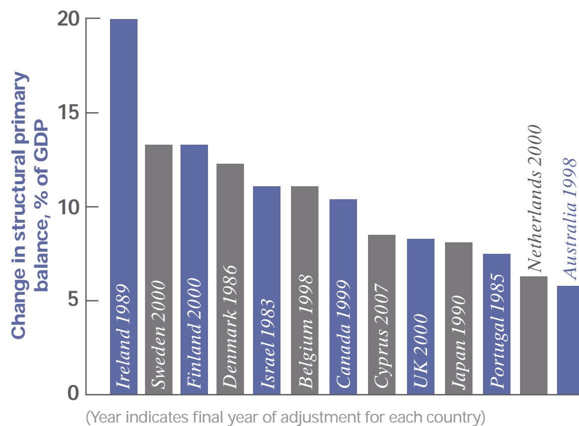
WHEN PRUDENCE PAYS OFF

Notable previous fiscal adjustments

Source: IMF, *The State of Public Finances Cross-Country Fiscal Monitor* (2009)



(Year indicates final year of adjustment for each country)

spending is continuing to rise. When government spend is close to 50% of GDP, it is very hard to support that without higher taxes." Between 1989 and 1993, Italy tried to rectify its deficit through tax rises, but growth slowed and private investment collapsed.

Making a sustained difference to public spending habits will not be easy but Downey says far-reaching change is possible. "UK Office for National Statistics data shows productivity in the private services sector rose by 20% between 1997 and 2007, whereas that in the public sector fell by 3%. If public sector productivity had grown at the same rate, public spending would be US$91bn (€71bn) lower and most, if not all, of the structural deficit would be eliminated".

Forget top-down, cut locally

With long-term costs rising in key sectors – such as health, education and welfare – gains in productivity and a culture of cost control are essential. In Canada, which applied its own version of Rogernomics in the early 1990s, one official told Oxford Economics: "The burden of efficiency savings will be placed on individual departments, which will have to identify the 5% of their programs that are under-performing and should be reviewed or scrapped."

This approach is intriguing because, Downey says, "Public sector reform has often been attempted through top-down measures. The evidence of the past 30 years is that the top-down approach in the UK has been ineffective or damaging and resulted in all kinds of bureaucracy and targets." When Canada cut spending in the 1990s, although prime minister Jean Chrétien received the credit, the truly tough decisions were passed to the provinces. Downey says: "It is often better to make changes by pushing deficit reduction down to local and state level. The community feels it has influence over decisions and there is evidence you get a better quality of decision."

Chris Wattie/Reuters/Corbis, Marty Melville/Getty Images, Carl Court/AFP/Getty Images, Xinhua/eyevine news agency

Some of the toughest decisions will be about how to re-engineer government. "Commercial organizations have dramatically changed their business models," says Downey. "We are now used to dealing with them through call centres, the web and distribution hubs, with in many cases a reduced number of high street branches. There's no reason why we shouldn't look at tax and benefit offices or the civil courts and ask if they could be radically restructured in the same way as banks and insurers." The scope is huge: KPMG says the UK allocates US$6bn (€4.7bn) of its social care budget to deciding how to spend the other US$12bn (€9.4bn).

Grow out of debt

Yet, as Sir Roger suggested, controlling deficits isn't entirely about cutting public spending. In their ten commandments for fiscal adjustment in advanced economies, IMF economists Olivier Blanchard and Carlo Cottarelli note: "Strong growth has a staggering effect on public debt. A one percentage point increase in potential growth lowers the debt ratio by 10% within five years."

This is the strategy Barack Obama would prefer to pursue in the U.S. Yet his deficit reduction committee is mired in ideological controversy. Keynesian economist Paul Krugman insists: "We are at a stage where we should have a kitchen-sink strategy. We should be throwing everything we can get at this. The most effective things you can do, in terms of bang for the buck, is actually have the federal government go out and hire people." Yet fears over Europe's sovereign debt – and America's deficit – have stymied even modest efforts to stimulate the economy from the public purse.

Uncertainty about growth hovers over the ambitious deficit reduction announced by the UK's coalition government. Chancellor George Osborne is conducting a root-and-branch reform of the public sector and trying to change the behavior of British citizens but that, Downey says, "is a cultural change that will take time" – and Osborne aims to be rid of the structural deficit by 2015. The UK election campaign earlier in 2010 illustrated the scale of the challenge he faces: televised debates between party leaders focused on US$9bn (€7.1bn) of cuts in public spending – equivalent to just 0.3% of the UK's GDP.

Every finance minister knows that the success or failure of their deficit reduction plans may be determined by something they can't control: the growth of a fragile global economy.

That uncertainty shouldn't deter governments from acting, says Sir Roger: "There were a lot of comments when we made our reforms that we were doing it in the wrong order. That's all fine in theory but in my experience, in politics, when you have a window of opportunity to do something sensible, you do it." ●

Find out more

G-20 2010
KPMG's guide to the political and economic fallout from the Toronto summit. See **www.kpmg.com/g20**

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BYD's Wang Chuanfu leads from the front

BYD undercuts to overtake rivals

Chinese car tycoon Wang Chuanfu wants to rule the industry – with a little help from Henry Ford

BY BRADLEY M. GARDNER

When Bill Gates and Warren Buffett cruised the country lanes of Omaha in a compact electric car in early 2010, their jaunt was no pleasure trip: they were test-driving the e6, the first foray into the North American market by BYD Auto, one of China's most iconic, and misunderstood, companies.

Since entering the auto business in 2003, BYD has hardly lacked ambition. In 2009, it launched six models and sold 480,000 cars, 98% in China. The 2010 target is 600,000, with 5-10% sold outside the country. Chairman and founder Wang Chuanfu, China's richest man (according to *Forbes* magazine) claims BYD will become the biggest domestic auto manufacturer by 2015 and the world's largest by 2025.

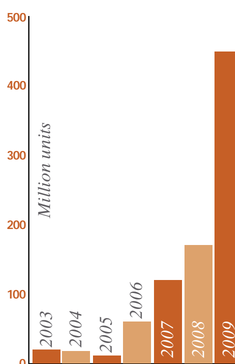
Such audacity attracted Buffett, who paid US$232m (€184m) for 10% of the company, on the advice of Berkshire Hathaway vice-chairman Charlie Munger, who called Wang "a combination of Thomas Edison and Jack Welch". Wang's unique management style (he famously drank a glass of battery fluid, takes competitors' models apart with a toolkit to understand their workings and jokes the company name stands for: "Brings you dollars") is only part of the story.

When Wang began making batteries in Guangdong in 1995, he invested less in fixed capital than in flexible human labor which was in abundant supply locally. BYD now has 200,000 employees in China, including 15,000 engineers. This focus helped BYD become one of the world's largest battery-makers, with products that cost 30% less than rivals, and a supplier to the likes of Apple and Nokia. Wang has perfected an extreme form of vertical integration which gives him control of every aspect of production and many links in the supply chain.

SUCCESS STORY

BYD AUTO'S SALES GROWTH SINCE 2003

Source: BYD



While automotive rivals look to outsource and platform-share, Wang's strategy might impress Henry Ford, a great integrator, and minimize costs. Wang admits: "If we put our staff in Japan or the U.S., we could not afford to do anything like this." Which does suggest the model will need refining as BYD expands outside China...

BYD's 2009 profit tripled to US$555m (€441m) year on year, 53% of which came from its car division. While Wang's foray into cheap electric cars has not been an instant best seller (BYD sold 15 last year, excluding government sales), it has won kudos and developed new expertise. André Loesekrug-Pietri, managing partner at Beijing-based private equity firm A Capital, says: "Moving from mobile batteries to car batteries isn't a linear step. BYD has shown it has strong execution capacity, and can appeal to customers and the government. It will now need an even more rigorous industrial process to make the quality right." The focus on electric cars may prove strategically useful in the long run. As Wang says: "For new energy vehicles, China is on the same level – or even leading other countries".

Once labeled a plagiarist (he admits BYD has "imitated" rivals), Wang has made his latest models strikingly original. "Good technology always comes from good companies," he says. David L. Sokol, a key adviser to Buffett, says any company could learn from BYD's model: "Many good entrepreneurs can go from zero to a couple of million in revenues and a few hundred people. He's got over 100,000 people. Few can do that."

Wang is a refreshing throwback to the days of such pugnacious mavericks as Ford and Walter P. Chrysler. Like them, he conveys the sense he puts "work first, life second". In an age of austerity, consumers might prefer tycoons who aren't scared of elbow grease. Or battery fluid. ●

Fred R Conrad/The New York Times/Eyevine

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The Galápagos effect

Japanese cell phones evolved in splendid isolation and are so advanced they leave the rest of the world behind. This may be their downfall

BY ANTONIA WARD

Japanese culture has long been exotically unique. In the 1970s and 1980s, rock groups who failed to make it in the West but had thousands of fans 'over there' were damned as 'big in Japan.'

Big in Japan can be big business – it is the world's third-largest economy – but there are still areas where Japan is strikingly different. Take its smartphone market. Japan has 100 million users of advanced 3G smartphones – twice as many as in the U.S. For many Japanese, the cell phone is the main way they access the internet. It holds metro tickets and employee ID. Cell phone novels are part of the daily commute.

The sheer volume of technology packed into these cell phones is impressive. It's not unusual for a Japanese phone to combine an LCD screen, GPS, barcode reader, camera, videoconferencing facility, digital TV and locking by biometric recognition. Feature-creep is endemic, leading to a 'wellness phone' that can check your body fat, track your calorific intake and – in an ominous precursor of a future full of nanotechnology and nagging – tell you when you have bad breath.

Japanese smartphones, though, have a problem. They're too different. Consumers in Japan had email on their phones in 1999, cameras in 2000, electronic payments in 2004 and digital TV in 2005. Most importantly, Japanese carriers settled on a standard 3G network as long ago as 2001, while the rest of the world dithered.

There is even a term for this problem: 'Galápagos Syndrome.' Like the endemic species of the Galápagos archipelago, Japan's cell phones are evolving in isolation. Major Japanese operator NTT DoCoMo's 'i-mode,' which has given Japanese consumers access to the web via phone since the late 1990s, relies on dedicated content and services. The Japanese cell phone ecosystem developed quickly, but with no outside influences – and is not in sync with the rest of the world.

All this was fine while the domestic market was growing, but recession and a fast-aging population have shrunk the market. And the success of the Apple iPhone in Japan – it has 72% of the Japanese smartphone market, according to the MM Research Institute – has highlighted the fact that Japanese phone software is now lagging. Cramming hardware into the popular clamshell format is making new phones bulky and, say some experts, stifling true innovation.

Could the problem be, then, that Japanese phones are too different from the rest of the world and not different enough from each other? Harvard Business School professor Youngme Moon's 2010 book, *Different*, says this kind of heterogeneous homogeneity means companies miss opportunities to stand out. "In category after category," she says, "companies have gotten so locked into a particular cadence of competition that they appear to have lost sight of their mandate – to create meaningful grooves of separation from one another. The harder they compete, the less differentiated they become."

This may be why two of Japan's biggest cell phone makers have just decided to merge operations. Together, Toshiba and Fujitsu will have an 18.7% market share, making their joint venture the second-largest Japanese phone maker after Sharp. If the two are mulling a push into overseas markets, they'd do well to heed Moon's words and think different: "The ones to pay attention to are the ones who understand the rules so well that they also understand the urgency to break them," she says.

Go further

Youngme Moon, *Different: Escaping the competitive herd*, Crown Business, 2010

Hiroko Tabuchi, 'Why Japan's cell phones haven't gone global,' *New York Times*, July 19, 2009

The Galápagos tortoise: highly evolved and found nowhere else in the world – much like the Japanese cell phone

Craig Lovell/Alamy

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10 issues that matter

Innovation is the engine of growth: but are you doing enough to nurture truly transformative ideas? Here are ten points to consider

01

If it ain't broke...

Last year, food manufacturer Ralcorp launched a marketing campaign for Shredded Wheat cereal that put the 'no' back into 'innovation'. It pointed out that the product had been made the same way for 117 years and asked why it would ever need to change.

The campaign was inspired by research that showed growing consumer skepticism about complicated formulas and unfamiliar ingredients. It also touched on an uncomfortable truth: sometimes, it really is better not to innovate.

Chris Taylor, who runs real-time strategy computer game company Gas Powered Games, has come to a similar conclusion: "For years, we've been beating the drum for innovation, but innovation for innovation's sake takes you backwards." Taylor likens the quest by some of his rivals for the right innovation to a car company launching a vehicle with five wheels. Eschewing flashy gimmicks, Taylor says Gas Powered is focusing on ideas that will enhance the core experience for gamers.

The downside is that not innovating can breed complacency. Wang Laboratories, the word processing and computer giant, once had annual sales of US$3bn (€2.37bn) but filed for bankruptcy in 1992 after failing to spot the rise of the general purpose PC. If you decide your core product is untouchable, be alert for trends that might, in time, turn that core rotten.

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02

The iPad paradox

Every CEO wants their innovators to develop an iPad, a desire that becomes more compelling with each stellar set of sales stats. Yet, paradoxically, this urgency may make companies less innovative in practice.

The Holy Grail of business, the disruptive innovation – such as the iPad – can transform a business, but for managers to insist on revolutionary breakthroughs, not incremental gains, is to misunderstand the process. Not every innovation is a blockbuster product: it may have to do with distribution channels or finance systems.

In 2003, agriculture multinational Cargill had an unusual problem: due to hyperinflation, there was not enough currency in Zimbabwe to pay its farmers. So it operated a credit program on an in-kind basis, enabling farmers to access seeds in return for cotton at harvest time. During 2006/07, Cargill's innovation provided US$4m (€3.1m) of inputs to 60,000 farmers.

Tom Kelley, general manager of U.S. design consultancy IDEO, says real innovation is often achieved in spite of head office: "Richard Drew, who invented Scotch Tape for 3M in 1930, bent or broke rules, fighting 3M's institutional resistance to risk-taking."

Rosabeth Moss Kanter of Harvard Business School says: "Companies don't need pendulums swinging to extremes. Incremental and breakthrough innovations go together."

If companies want to innovate successfully, leaders need to ensure they're not afflicted by tunnel vision.

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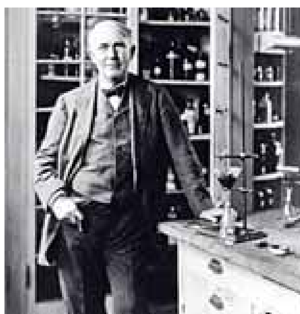
03

Metrics matter



Innovation can, as Thomas Edison *(above)* observed, be a process of finding "10,000 ways that don't work" before hitting on a winning formula. But identifying which ideas are winners can be a challenge – especially when, *BusinessWeek* suggests, only a third of the Fortune 1000 employ any metrics to assess whether they innovate successfully.

Scott D. Anthony, author of *The Silver Lining*, says management can analyze innovative ideas by asking three questions: firstly, what size matters? In other words, how big does an opportunity have to be to matter inside a firm?; secondly, what is a simple calculation that crosses that bar?; and finally, what leads you to believe that calculation is plausible?

It may sound basic but, Scott says, "This captures many of the elements of an idea's business model". If you can't answer these simple questions, he suggests, don't waste time creating complicated spreadsheets.

Some companies judge innovation on the size of the R&D budget, number of patents filed, number of active projects or the revenue generated by them. Others use more qualitative judgements – assessing a manager's willingness to take risks in the name of innovation was popular for a while. Between eight and 12 metrics is generally seen as the ideal number.

> "Only a third of the Fortune 1000 employ any metrics to assess innovation"

Chu Woo-sik, senior vice-president of Samsung, says it focuses on price premiums, speed of execution and customer satisfaction – and monitors its success rates: "Many firms fall into the trap of thinking things are improving – when in the end it doesn't work out that way."

04

Join the culture club

Most CEOs have no accurate impression of how innovative their employees might be, as they have no idea how many ideas die in what consultants call the "First Mile".

Ideas often languish, not because they are bad but because there is something wrong with the metrics, organizational structure, strategy or incentives. To change, organizations need to develop a culture of innovation. Bruce Nussbaum, the innovations editor of *BusinessWeek*, suggests that firms trying to develop such a culture can learn from Silicon Valley *(below)*, where the culture starts with the right kind of brainstorming – building on suggestions rather than screening them for efficiency. Choosing new technologies and investors to drive innovation is part of the fabric of business life there. In this ecosystem even failure is celebrated as a means of learning. As Paul Saffo, professor of engineering at Stanford University, puts it: "Spires of success are built on the rubble of failure."

Max Levchin's first startup, a software scheduling system, was beaten to market by an established rival. But the Ukrainian entrepreneur came back and co-founded PayPal, selling it to eBay for US$1.5bn (€1.2bn) in 2002.

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05

Genius clause

The question Tinker Hatfield gets asked most often is, he cheerfully admits, "Where's the stuff?" The head of Nike's 'innovation kitchen' sometimes infuriates other senior executives because he isn't judged on sales: his 'genius clause' allows his department to deliver fresh thinking without worrying about being held accountable. It's a strategy that gave Nike the Air Jordan shoe *(above)* and 'flywire' technology – and might be the key to kick-starting innovation in larger companies.

"Breakthrough innovation has been very difficult for large, established companies," says Gina O'Connor, co-author of *Radical Innovation*. "Projects get shut down because senior management loses patience." O'Connor advocates allowing staff the opportunity to pursue side projects or semi-official 'skunkworks' groups.

Google famously allows employees '20% time' to devote to their own work. Biotech company Genentech's 'discretionary time' can reach 50% of working hours, but it led to the business's most successful drug, Avastin, which began life as an engineer's pet project. Sales of the anti-cancer drug are expected to hit US$8.9bn (€7bn) by 2016.

Removing the pressure to deliver helps creatives to innovate, but only bigger firms can really afford the luxury of nurturing genius.

06

It's in the DNA

'Can you prove it?' Those four words can kill innovation, a delicate plant that can't be forced, but needs light and space to grow.

Bernard Brown, KPMG's Head of Business Services, says: "The best businesses encourage brainstorming first. Don't introduce cost too early, or ask your creative people to understand the cost of production. All they will do is use their normal production processes – and not consider if there is a better way of doing it."

Innovation is so uncertain that many managers seek safety in number-crunching, but innovation consultant Larry Keeley says numbers will only take you so far: "Innovation cannot be done formulaically."

Keeley argues that the first need is for companies to understand their "innovation DNA – what is it that you do best?" He understands why so many managers ask for proof: "The goal is to focus on a very few bold ideas that tend to work, rather than have a million ideas that tend to fail."

Procter & Gamble's launch of its Align probiotic supplement proves Keeley's point. The original forecast for this pill, which eases irritable bowel syndrome, was modest. P&G nearly shut the business unit down. Instead, after further study, it decided to launch the brand quietly – and cost-effectively – over the internet in 2007. Feedback improved the product and brand and Align was given a full, successful launch in 2009.

07

China learns to innovate

Healthy patent filings are a sign of the country's eagerness for home-grown R&D capabilities

To understand the reality of innovation in China, you need to look beyond the popular narrative which suggests the country lags behind in innovation – and that its firms have huge ground to make up on foreign-owned multinationals. My experiences suggest that a better understanding of the R&D world on the ground paints a very different picture.

Let's start with the numbers. In 2008, according to the World Intellectual Property Organization (WIPO), China filed more than 289,000 patents, a total surpassed only by the U.S. and Japan. Many of these patents emanate from wholly-owned subsidiaries of multinationals or joint ventures involving overseas firms, but domestic 'latecomer companies' are catching up. State-sponsored R&D in China rose at an average annual rate of more than 30% in the decade to 2005, while huge numbers of science and technology graduates have been added to the talent pool.

It is also a myth to say that domestic firms only care about imitation. Chinese companies may start by adapting a rival product, but many quickly develop the capabilities and confidence to bring out their own innovative offerings.

The nature of international R&D is changing. It is no longer driven by national or regional markets and is focused more on fundamental research. R&D facilities in China are seen not as quasi-independent, disparate units but as one integrated whole able to make a major impact.

Intellectual property remains an issue. Protection is far from adequate, but while this can lead to lower returns on R&D spend for multinationals, it can be minimized through smart management. And with some companies claiming R&D costs can be halved by offshoring, it isn't hard to understand why companies such as HP, DuPont, Intel and Motorola have invested so heavily in the country.

The challenge for China is to encourage its companies in innovative capabilities without the incentive of foreign involvement. There is every sign it understands what is needed to bring about such a sea change.

By Professor Jiatao Li, director of the Centre for Business Strategy and Innovation at the HKUST Business School, Hong Kong

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08

Disrupt the status quo

If innovation comes too easily to your business, you could be in trouble. Ideas that companies are comfortable with are what Clayton Christensen, professor of business administration at Harvard Business School, calls "sustaining innovations" and, he warns: "By only pursuing sustaining innovations, companies open the door to disruptive innovations."

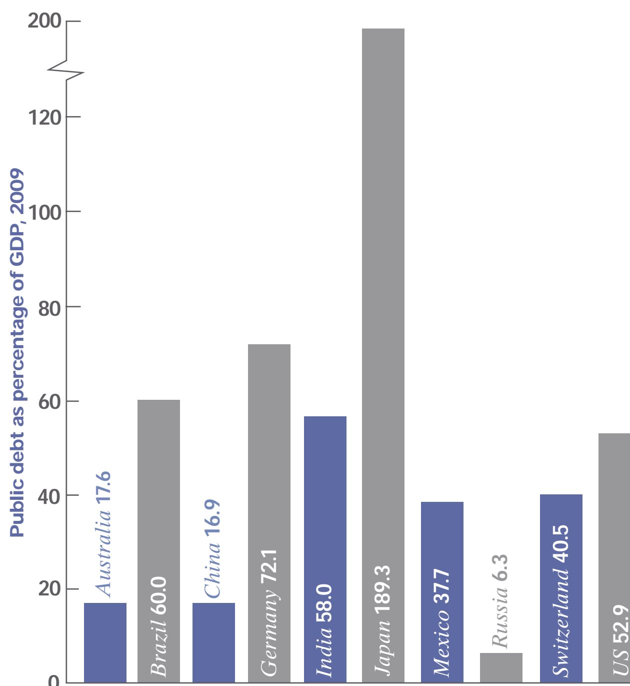
One striking example of this tendency is mobile phones, where few fixed-line telephony giants lead the market. Their failure illustrates a crucial point: with sustaining innovations, the incumbent usually wins. With disruptive innovations, new entrants usually triumph – as Dick Fosbury proved when he won gold in the high jump at the 1968 Olympics with a distinctive 'flop' *(below)* style that was initially ridiculed by many.

Incumbents can be disruptive innovators too. Nintendo went beyond customers' expressed desires to transform the market with the Wii, which sold 71 million units in its first four years. Nintendo's Genyo Takeda says: "We could have tried to improve the speed at which it displays stunning graphics, but how much impact would that really have had?"

RUSSIA'S DEBT RESULT

Why Moscow leads on public debt

Source: CIA World Factbook



09

Medvedev gets creative

It's not every business school that opens its doors with US$500m (€387m) in backing and US$100m (€77m) in venture capital for its students to draw on. But then Skolkovo Moscow School of Management does have the backing of Ruben Vardanian, CEO of Troika Dialog (one of Russia's largest banks) and soccer-loving billionaire Roman Abramovich.

Skolkovo is the most tangible proof that there's more to president Dimitri Medvedev's innovation drive than rhetoric. Medvedev has identified that Russia needs to reduce its dependence on raw materials and energy and develop its knowledge economy. He has no public debt (*see graph*) so can spend freely, but the obstacles are formidable. Robert Hormats, U.S. undersecretary of state for economic, agricultural and economic affairs, says: "Russia already possesses key elements for innovation. But to really take root, innovation must be given a fertile legal and cultural environment and government policies to support entrepreneurship."

Legal reforms are mooted but in the meantime, Medvedev welcomed 24 venture capitalists from Silicon Valley to Moscow in May. Headline successes – including a pledge to invest US$1bn (€770m) from Cisco – suggest he is making headway in turning Skolkovo into a Russian Silicon Valley.

10

Social media can deliver

Can social media ramp up the 'open innovation' revolution that was designed to make R&D more effective through the power of 'crowdsourcing'? Some major firms believe it can.

IBM has 100,000 staff contributing to 17,000 company-wide blogs and its internal wiki generates a million page-views a day. The external blog 'Smarter Planet' showcases staff ideas on green technology.

Bernard Brown, KPMG's Head of Business Services, says factories once had suggestions boxes to empower staff and improve process: "Social media make that sort of tool even more readily available."

Companies such as Cisco and AMD encourage staff to join microblogging site Yammer, where colleagues share what they're working on, producing unexpected collaborations and solutions.

At leading outsourcer Tata Consultancy Services, staff comment on ideas through its internal social network, IdeaMax. Chief technology officer K. Ananth Krishnan says this clears the path for innovation. "If I come up with an idea, whether incremental or disruptive, I need to know where to go with it… the wisdom of crowds works for us."

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Sustainability

CAN WE AFFORD TO WAIT FOR THE PAYOFF?

If you haven't gone green, the market may force your hand. Now is the time to turn the environment to your competitive advantage

BY ROBERT JEFFERY

Any company that hasn't considered how the environment will affect its future production probably doesn't have much of a future. Going green makes business sense – socially responsible investment funds currently account for 17% of European investments and 11% in the U.S., according to research company Celent – and may preempt punitive legislation. If businesses don't act, Sir Nicholas Stern predicts climate change could do as much economic damage as the Great Depression and two World Wars combined.

Agenda explored the business world's attitude to the environment in conversation with: Yvo de Boer, special advisor to KPMG's Sustainability practice and former executive secretary of the United Nations Framework Convention on Climate Change; Ted Senko, KPMG's Global Chief Executive, Climate Change and Sustainability Services and a partner in the U.S. firm; and Ian Cheshire, group chief executive of Kingfisher plc.

What should sustainability mean to the typical CEO?

de Boer The original three pillars of sustainability are economic, social and environmental. The ideal is that in each of those domains you leave the world in a better place. That concept has gained a lot more meaning in recent years, especially for CEOs: energy prices have clearly become an issue, energy security is a problem in many parts of the world and scarcity of raw materials is becoming a concern. So companies and countries take sustainability much more seriously in practical terms.

Cheshire The starting point for any business is to ask 'how sustainable are we?' If you're going to sell sustainability solutions to customers, you need to demonstrate that you're walking the same walk, otherwise it's greenwash. Models for earning money in the future will have to reflect sustainability – the sooner you start incorporating it into the way you do business, the sooner you find a way to get ahead of the competition.

de Boer Certain countries, notably China and Korea, used the economic crisis as an opportunity to change the direction of growth and put sustainability at the heart of their future. That shows sustainability has left the periphery and is now centre stage. It has become a hard-nosed business case you cannot afford to ignore, and if you waste energy or squander raw materials, the marketplace will punish you in cold, hard financial terms.

Should we expect greater regulation?

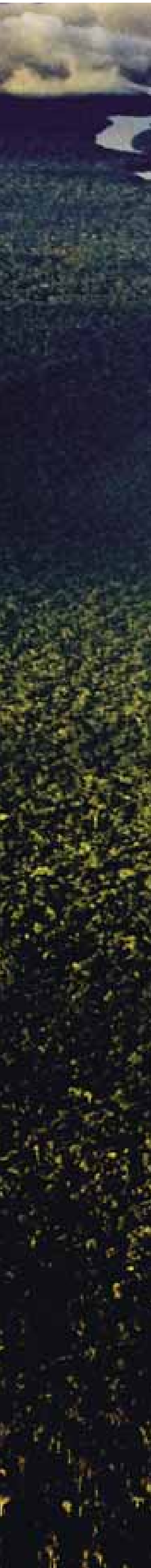
de Boer It is up to governments to provide environmental policy. After the climate change conference in Copenhagen, all industrialized countries have submitted targets for the year

The panel

1 Yvo de Boer
Special advisor to KPMG's Sustainability practice and former executive secretary of the United Nations Framework Convention on Climate Change

2 Ted Senko
KPMG's Global Chief Executive, Climate Change and Sustainability Services and a partner in the U.S. firm

3 Ian Cheshire
Group chief executive of Kingfisher plc, Europe's largest home improvement retailer with 840 stores in eight countries. Winner of the 2010 BCE Environmental Leadership Award



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Under threat
Brazil's Mato Grosso region, the world's largest tropical wetland, has suffered devastating deforestation

Bloomberg, Fernanda Preto/Getty Images; AP/Press Association

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Beyond greenwash

Business is often cast as the villain in the sustainability debate. But Yvo de Boer (above), who spent four years as one of the leading authorities on the subject, says the reputation doesn't match reality: "A lot of companies in different sectors are taking this issue very seriously. For example, in the energy sector the common belief was that during the economic crisis, investment in renewable energy was on the decline. In fact, it has been increasing in wind, solar and battery technology.

"In the automotive industry, a number of car companies that for many years opposed environmental legislation are now seeing market opportunities in hybrid and electric vehicles. And chemical companies are looking at their track records in energy efficiency. In every sector, even airlines, leaders are emerging who see climate change not as a threat but as an opportunity."

De Boer's lengthy career with the United Nations, overseeing the introduction of climate change legislation, followed a spell as environment minister of his native Netherlands. And he points to one of his corporate compatriots as an example of a company in an energy-intensive industry which sees danger ahead: "Shell has very clearly said that it wants to be part of the clean energy agenda. And countries in the Middle East that currently account for 10% of the world's oil supply would like to supply 10% of the world's energy demands when that runs out. Whole countries and major companies are seeing themselves as energy providers."

For business leaders still unsure about the burning platform for sustainability, he has a literal – and alarming – metaphor: "Think about putting a frog in a pot of cold water and boiling it. You can't believe the frog doesn't jump out, but of course it doesn't notice the gradual change in temperature. It is very dangerous for us to treat population growth or water scarcity in a similar way, believing that because they're smaller, less noticeable changes they don't matter."

2020, and 35 developing countries including China, India and Brazil have national action plans. These countries are already regulating.

Senko First movers can create a competitive advantage by looking at sustainability from a risk perspective, because the flip side of risk is opportunity. By understanding the impact of climate change on your business, and moving before regulation takes effect, you can create competitive advantage.

Cheshire The right balance of government framework and market delivery is crucial. There are limits to where the market can operate – it can't easily price carbon at the moment, for example, but the answer is to introduce a stimulus and let the market drive it through. The move to unleaded fuel is a good example: cutting duty on unleaded and raising it on leaded fuel was a fiscally neutral way of driving real change.

To what extent have companies made sustainability part of their culture?

Cheshire We've made it clear that sustainability is part of our business strategy and value set. That's a big challenge in countries where there is no tradition of sustainability. China has come a long way in the last five years, for example, but doesn't have the same cultural approach as the UK. We've also made sustainability one of the key objectives in our annual bonus scheme for a large chunk of our senior management.

> "Companies should open up completely over sustainability. There's nothing to be afraid of"

Senko Sustainability is becoming a significant issue in supply chains. Retailers are setting aggressive goals and pushing suppliers to meet benchmarks. The changes caused by those kind of initiatives are truly dramatic.

Greenwashing is a frequent charge for business. How would you answer that?

Senko This is where corporate sustainability reporting comes in. Industry groups are trying to develop standards for reporting sustainability, and that will be key to providing clear figures.

Cheshire We have NGOs on our stakeholder panels and we're fully transparent. We've spoken to Greenpeace, for example, about the situation with sourcing wood in China. After a few conversations, people can tell the difference between a company that is only involved in sustainability to try to get away with other stuff, and those who are making a fundamental effort. My advice would be to open up completely. It's nothing to be afraid of.

de Boer There are hole-in-the-wall operations out there selling carbon offset certificates that are not worth the paper they're written on. They're not leading to any kind of meaningful emission reduction and can actually leave

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companies in a worse situation, because they are open to accusations of greenwashing.

Is it desirable, and feasible, for companies to be judged on green criteria as they are on their balance sheets?

Senko When we have timely, accurate, relevant information about sustainability it should be treated in a similar way to financial information, including being audited to give it credibility in public markets. There's a very clear movement among major businesses to develop a system of public reporting that goes beyond financial information. Investors need more information than just historical financial results to decide who the winners and losers are.

Cheshire We comply with quite a few measures, including FTSE4Good. We're very open, but there's still a real disconnect between those sorts of measures and shareholders' interests. Some ethical funds ask direct questions, but a lot of institutional shareholders pay little attention to sustainability. People need to realize that failure in the sustainability arena is very damaging to your reputation and financial performance.

de Boer We're already seeing it from a number of major companies, particularly in the food and retail areas. Financial institutions want to know more about how a company is performing. I expect governments will increasingly expect the private sector to encourage greater reporting.

Is it inevitable that business and the green lobby won't see eye-to-eye?

Cheshire I've found that NGOs and corporates getting together is actually very powerful. Instead of the government wagging a finger at people, isn't it better to have trusted brands and organizations getting together? There will always be outliers – the odd business that won't behave, and the odd NGO that is only interested in bashing the capitalist business model. The majority want to move things forward.

Senko Businesses understand the dynamics around energy supply and security, resource demand, population growth … they know they have to respond to these challenges. It's not about where you agree or disagree. It's not just about being a good corporate or global citizen. These things are going to change your business model unless you innovate.

If you had to pick one particular aspect of sustainability that is most important to address, what would it be?

Cheshire Energy efficiency. In a lot of businesses it's not the responsibility of anybody in particular, but energy efficiency – all the way back through the supply chain – affects climate change so directly.

de Boer The first aspect, which keeps me awake at night, is how we are going to give nine billion people a reasonable lifestyle without running everything into the ground. If economic growth and eradication of poverty are key global goals, we can only achieve them through a fundamentally different economy. The second issue is that we're going to see an investment in the energy sector of more than US$20 trillion (€15.6 trillion). If that is made without taking climate change into account, it will push greenhouse gas emissions up 50%. At the same time, the scientific community is telling us we need to reduce emissions by 50%. Once these things get out of control, it's very difficult to turn the clock back. ●

When going green pays

WAL-MART
The retailer has asked suppliers to go green; reducing packaging will save US$3.4bn (€2.6bn) by 2013.

PROCTER & GAMBLE
Foresees a US$20bn (€15.6bn) market for 'sustainable innovation' products, including washing powders that work at low temperatures.

MARKS & SPENCER
A 'Plan A' green drive ("because there's no Plan B") aims to make the British retailer the world's most sustainable. It has also saved the company US$76m (€15.6m) over three years.

CISCO
A move to a greener supply chain yielded US$12m (€9.4bn) in savings, as well as environmental kudos.

Tree of life
Scarcity of raw materials, such as Chinese timber, poses a quandary for many multinationals

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acumen

Reset, remodel, reward

As the manufacturing economy 'resets' to knowledge and service, firms who unlock their workforce's creative potential will be the winners, says author Richard Florida

BY ROBERT JEFFERY

Will 2011 mark the painful birth of a new economic era? Leading business author Richard Florida certainly believes so – and he has history on his side. Recessions have caused seismic economic shifts before. In the 1870s, the Long Depression sealed the transition from an agricultural to industrial economy and ushered in industrial growth. In the 1930s, a new consumer-driven economy emerged from the agony of the Great Depression. Florida believes we are now on the brink of a third 'reset' of the global economy, as science, knowledge and service replace consumer goods as the drivers of growth.

"The housing, energy, consumption bundle was the powerhouse of the industrial economy. Now we're in an economy of information, technology, science and knowledge, where we need more skill development. Things that used to signify wealth and security – home ownership, new cars, luxury goods – will be replaced by more experiential consumption like travel, recreation, self-improvement and so on," says Florida, director of the Rotman School of Management's Martin Prosperity Institute and author of *The Great Reset*. If he is right, the implications for business and government are profound.

The U.S. Bureau of Labor Statistics predicts the country will lose 1.2 million manufacturing jobs by 2018 – but employment in professional occupations and services will rise by 17% and 14% respectively. And the service sector accounted for 78.3% of U.S. private sector GDP in 2009.

Some technology giants have anticipated this shift. Hewlett-Packard bought EDS for US$13.9bn (€10.8bn) in 2008; services now account for 28% of its revenue. IBM, once synonymous with PCs, sold its PC manufacturing operation in 2005, and is now the world's largest IT services company.

The shift from a manufacturing-based economy started a while back, but not every company has adjusted its strategies accordingly, even though the effect on the engineering and automotive industries has been obvious and dramatic. Florida says, "Design-intensive industries, including goods-producing ones like fashion and furniture" will be next: "They face even fiercer competition from rapid copycatting, mass production and distribution. These industries will have to excel at constructing powerful, authentic experiences, differentiating their products from knock-offs and building strong brands."

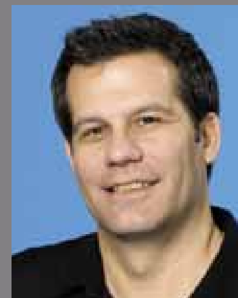
This resetting is, Florida says, a vindication of management guru Peter Drucker, who believed that companies gained a competitive edge by investing in a "community" of human capital, not automation or faster machines. With the internet levelling the global playing field, service is even more of a differentiator, a trend which will force the service sector to reinvent itself.

For Florida, the low-pay, low-added value model, where firms treated staff "as not only liabilities, but as enemies" needs to give way to something more creative where businesses can generate added value. Hotel chains like Mandarin Oriental are the service business of the future, he says.

The service sector can learn from manufacturing: "We made manufacturing work more efficient. We organized workers in teams. We had them contribute to productivity and engage in quality circles. The better service companies are suggesting service work can be more efficient. As they engage in continuous improvement, as they work in teams and make suggestions, they make more pay."

For this urban – and distinctly urbane – theorist, the lessons of the economic crisis are clear: "Companies that fared well during the recession focused on improving their productivity by getting the most out of their employees, particularly their problem-solving and creative abilities. These companies also re-focused and improved on their competencies: they did not take on new ventures outside their competitive advantages."

And if he were a CEO, what would he do next? "I'd be striving for the win-win, where my firm could be more productive and harness more of the creative potential of my workforce. I would be building the reward systems and necessary institutional mechanisms to do so. Great resets give us the opportunity to remake ourselves in the wake of a crisis." ●



"Companies that fare well get the most out of employees' problem-solving and creative abilities"

Go further

More from Richard Florida on a more innovative future www.kpmg.com/agendaonline

Richard Florida blogs on our reset global economy www.creativeclass.com

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Could you plan your operations from your iPhone?; plus business books at a glance

need to know
ERP 2.0

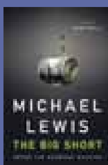
ERP 2.0? Is that like Web 2.0?
In a way. ERP 2.0 does utilize Web 2.0 tools, but the new label is more to do with reinventing the platform in the same way the internet was 'upgraded'. Enterprise resource planning (ERP) software gained a foothold at the end of the last century and global spend hit US$20bn (€16.3bn) in 1999. But systems haven't kept pace with agile software and mobile technology. "People go to work and use old technology, then go home and use shiny new technology," says Bryan Cruickshank, Global Head of IT Advisory for KPMG. "They know there's greater capability."

Isn't this just a way for vendors to create buzz?
ERP has long been viewed with suspicion in the C-suite. In January 2010, major U.S. jewelry retailer Shane Co filed for bankruptcy, blaming the "ballooning" costs of a major US$36m (€28m) ERP installation, which led to overstocking and other inventory problems. But Cruickshank says that early ERP 2.0 adopters in oil and financial services – industries where handling real-time information is vital – believe their investments have been successful.

How is ERP 2.0 different?
"A lot of management information used to be generated in silos and passed up the chain," says Cruickshank. Not any more. New systems can be synchronised with suppliers and customers to create valuable information, and can work on mobile devices, for more efficient global supply chains. Planning and scheduling algorithms have been streamlined: Procter & Gamble's 'real-time forecasting' improved cash flow by US$100m (€81m).

What are my next steps?
Understand your current systems and which new advances can meet your strategic goals. Create a multi-disciplinary team involving IT and key business functions. Most important of all, says Cruickshank, build a business case that takes account of the realities of implementing a new system, not just the benefits.

business reads
Books with insight for the busy CEO



The Big Short **by Michael Lewis (Penguin)**

Unlike other commentators, Lewis brings few pre-conceived ideas to his chronicle of the credit crunch. He finds no glee in the derivatives-led collapse, but uses interviews and insight to show how the lessons of the past weren't passed on to a new generation of leaders, and how a handful of maverick managers bet against the market. In the hands of the *Liar's Poker* author, the detail isn't rushed through, but the portraits are vividly painted.

The End of History and the Last Man **by Francis Fukuyama (Harper)**

Fukuyama's treatise on the spread of liberal democracy says "the struggle for recognition is the motor that drives human history". Leaders need to realize, he says, that our desire to be recognized is as basic as our need to eat. In a business world often swayed by fads, Fukuyama's long view is a revelatory read which sheds intriguing light on the forces that drove such entrepreneurs as Henry Ford and Ted Turner.

The India Way **by Peter Capelli, Harbir Singh, Jitendra Singh and Michael Useem (HBS Press)**

There are plenty of books examining the rise of the Indian economy, but *The India Way* stands out. Four academics ask 100 executives from the most successful Indian companies about their business methods and traits. The result is sobering for multinationals who believe it's possible to export their business model to a country where corporate life must co-exist with social responsibility.

Eightfish/Getty Images

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"Ask yourself: could a fool run your business? Someday a fool probably will"

Warren Buffett

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