



# **IAFEI QUARTERLY**

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**48<sup>th</sup> Issue – June 2020**



## Message from the Chairman

Dear IAFEI members,

Greetings from Manila, Philippines!

We present to you the 48<sup>th</sup> issue of the IAFEI Quarterly.

We are in the new normal. The disruption brought about by the COVID-19 pandemic is unprecedented. No one was spared. Lock downs and community quarantines had to be implemented which caused economic slowdown, stoppage of businesses, and loss of livelihood. Even the biggest economies of the world are tremendously shaken. This pandemic changed the current global landscape, the way we do business and the way we live.

I share the sentiments of some of our member-institutes and its members. This situation has gravely affected their finances, sustainability and has made them revisit and adjust their business models

Despite all these, I believe that we can overcome these uncertainties. In these trying times, we must be united. As finance executives, we must be the model of resiliency and adaptability.

Amidst this crisis, we will continue to improve the services that IAFEI provides to your organization and members by providing new value proposition. IAFEI is also moving towards digital. Virtual conferences will be rolled out in the coming months.

I would like to thank all of you for all the support. Together, we can win over this, STRONGER and BETTER.

For any suggestions and comments, you may share it through the IAFEI Secretariat at [mbvinluan.iafei@gmail.com](mailto:mbvinluan.iafei@gmail.com) and [secretariat.iafei@gmail.com](mailto:secretariat.iafei@gmail.com).

Thank you and all the best!

Sincerely,

EDUARDO "Ed" V. FRANCISCO  
Chairman

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## The Post-COVID Enterprise - Outmaneuvering uncertainty

by **Mauro Marchiaro**, Senior Managing Director Accenture, Italy,  
and by **Riccardo Volpati**, Managing Director Accenture, Italy

As European societies and businesses are reopening and start navigating the “new normal” (or shall we say... “never normal”), all of us are still dealing with the aftermath of the lockdown and the learnings that can be drawn from it. The crisis is pervasive, deeply impacting all areas of the enterprise with no exception. A recent study from Gartner shows that only about 12% of organization were highly prepared for the impact of coronavirus<sup>1</sup>. Business continuity and disaster recovery plans have been tested by rapidly evolving challenges, such as travel restrictions, and large-scale remote working suddenly became reality. Business process functions, including finance, supply chain, procurement, human resources, marketing, sales and customer operations, are being severely disrupted. During the lockdown days, many of us directly experienced how valuable it is to count on shared values and corporate culture, trusted and compassionate leadership, flexible and digitally equipped work environments, robust and resilient business processes and effective cyber security protocols. These factors have proven very important for us to preserve our safety and well-being, while trying to minimize adverse impacts on the performance and value of our businesses. As we emerge from pure crisis management, how can we leverage this experience to build more resilient organizations going forward? And to what extent will this apply to the role and mandate of Finance Leaders?

There is no single answer to such questions, as needs and priorities vary substantially across different organizations based on factors such as industry and geography, pre-COVID financial Health, competitive positioning and degree of digital maturity, among others. But one thing is for sure: finance is one of the predominant topics to be dealt with as part of COVID response.

According to Accenture research on CEO sentiment, finance issues represent approximately 25% of the discussion topics they need to address as they face the crisis. In these times, decisions and actions taken by CFOs can have an immediate effect on the survival of the company, its time to recovery, and longer-term sustainability.

In this short article, we will provide some selected highlights regarding priorities for CFOs as they withstand impacts from downturn and accelerate recovery.

### Manage Total Liquidity<sup>3</sup>

Since early March 2020, risk of financial distress became the primary concern for many Finance leaders. The following table shows an analysis of the Altman Z-Score (a formula used to analyze bankruptcy risk) of the S&P500 companies conducted by Accenture. 210 companies were in the distress zone in late march 2020.

Altman Zones	Range	S&P 500 Companies (March 2019)	S&P 500 Companies (March 2020)	Change (+/-)
Safe Zone	$Z > 2.99$	236	174	-62
Grey Zone	$1.81 < Z < 2.99$	104	116	+12
Distress Zone	$Z < 1.81$	160	210	+50

Source: Accenture analysis of Capital IQ data. Data as of market close on Mar 20, 2020.

In the short term, CFOs are given the task to secure and strengthen existing financing sources and look to create financial breathing space. As part of this endeavor, they should ensure they have two capabilities supporting the core of finance and liquidity management activities:

**A liquidity “control tower”:** a single view of all aspects of liquidity, linking information related to receivables, payables, inventory, risk, taxes and cash flow, through a 360 degree governance framework; This helps establish targets and develop action plans, communicate and coordinate with operations, drive needed change and allocate resources. The liquidity control tower also helps the CFO manage risk and communicate effectively with banks, the investment community and other business stakeholders on measures taken and their impact.

**Data and analytics capabilities:** The finance function should develop programmatic ways to manage liquidity by leveraging data and analytics. Actions and impact assessments should be enabled in days, as opposed to weeks or months, through dynamic scenario-based forecasting models. These models should be agile, adjusting forecasts and outcomes to rapidly changing scenario inputs. Bias to action should be the fundamental underlying principle.

### Pursue resilience through M&A<sup>4</sup>

In phases like the current one, the M&A market contracts. Deal volume in the first quarter of 2020 dropped to a seven-year low, down 33% from the year before. This sharp drop looks consistent with other economic shocks, where the decrease in deal value approached 50%. Crises often trigger consolidation in sectors that bear the hardest impact, such as the banking and travel sectors during the 2008 Financial Crisis. However, companies that have strength to make M&A moves in the downturn typically outperform those who do not. In any crisis, there are selected opportunities to acquire high-quality talent, intellectual property (IP) and capabilities, often in distressed situations. For those in a position to acquire, these investments can be critical to long-term resilience while also helping distressed companies preserve capabilities and talent versus facing potential bankruptcy.

In this evolving context, forward-thinking Finance Leaders who are able to rebalance for risk and liquidity in the toughest days of the crisis are more likely to seize opportunities for non-organic growth that can be triggered by M&A. M&A in down periods is an important enabler for recovery and growth, and history shows that companies who bought in a downturn tend to have a higher three-year shareholder return than their sector average<sup>2</sup>. For these reasons, CFOs should update their near-term M&A agenda in response to the crisis and convert their new funnel of priorities into deal management pipeline.

### Shape a super-responsive finance function

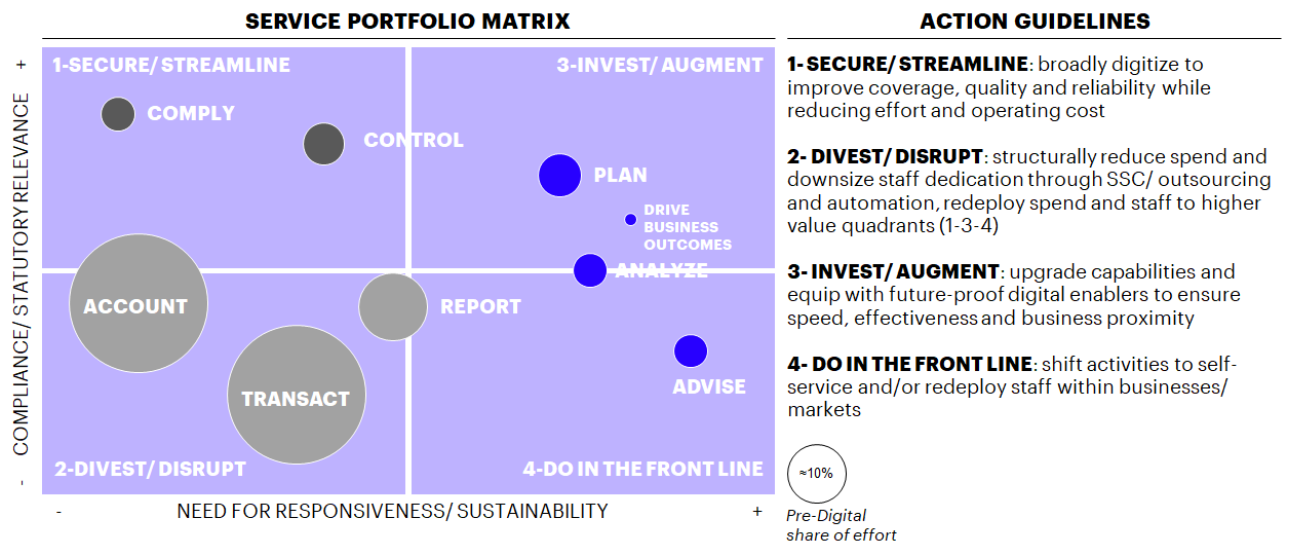
COVID-19, as well as other ongoing and upcoming challenges urge Finance Leaders to be super-responsive and market focused. An energy multinational player, who still runs a traditional, mostly bottom-up planning process based on a pre-determined scenario, taking several weeks to be fully completed, had to completely redo their midterm plan, released in February, almost from scratch in early March 2020. This was an extremely painful exercise that had to take place at the peak of the unprecedented turbulence driven by the demand shock coupled with the price war that was dragging oil price of oil below \$20. Similar situations were common to many businesses across multiple industries. Events like this show that the progresses in the role and capabilities of the finance function, which were already thought of as inevitable, are becoming extremely urgent and immediately required. The never normal calls for substantial redeployments and rapid responses informed by high-velocity scenario planning and simulations, as well as data-driven financial insights. In front of such challenges, CFOs are urged to be super-responsive, and to reframe their portfolio of services by divesting low value-added transactional activities in order to free up time and resources to double down on business advisory, analysis and planning capabilities upgrades. CFOs are now required

take an even more critical view at their functions and departments, to structurally reduce spend and downsize staff dedication on accounting reporting and transactional tasks, while redirecting spend and staff to build stronger, future-proof front-line finance capabilities.

Market capitalization losses since the start of the COVID-19 crisis.<sup>9</sup>



Source: Accenture analysis of the world's 2,000 largest publicly listed companies, data as of February 21 –March 16, 2020.



### Adjust to a permanently different operating model<sup>5</sup>

Since early March, many corporate organizations switched to remote working at unprecedented speed and scale, often far exceeding the extent to which their processes and IT infrastructure were designed for. “We have a client who asked us literally to go from zero people using Teams to their entire 61,000 workforce in five days” Julie Sweet, CEO of Accenture, recently said. But as the crisis unfolds, it is reasonable to hypothesize that our way of working in the post COVID-19 scenario will not be the same as before. How should Finance Leaders act to embed this new way of working in their operating model and to improve resilience of the finance workforce? Accenture has learned that it is possible to not only secure and reshape critical functions within three to six weeks, but also establish a cohesive set of leading practices that can be scaled across all operating locations—both now and as the scenario will stabilize. Below are 3 guidelines that finance organizations should factor in their post-COVID set-up:

- Implement agile and elastic workforce models: The best combination of working from home and the office, depending on the nature and type of work and relevant skills required, can be enabled by technology, data, security and cloud computing. Current investments in technology and the related infrastructure make such scenarios possible; in the future, this fluid approach is likely to become the standard.

Elastic workplaces using agile leading practices, align with millennial expectations—“log in anytime, anywhere” employment that maintains flexibility and privacy.

- Build a human + machine workforce: by creating a human+machine workforce, people can be reskilled and redeployed to ensure continuous operations while using analytics, AI and real-time monitoring. Machines capable of continuous learning could provide an ideal basis for further scaling operations
- Adopt a distributed service model: future organizations will not be driven by their headquarters or dependent on offices. Use a mixture of service models to de-risk the organization in a volatile world. Distributed global services mean that high performance can be delivered anytime, anywhere.

In the highly uncertain scenario we are in, it is very hard to make predictions. However, it seems likely that the post-COVID enterprise, as well as the post-COVID finance function, might look lastingly different from before.



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**Riccardo Volpati**  
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- (2) Accenture analysis of CapitalIQ data, 2020
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## Opinion Statement FC 3/2020 on the Directive on Tax Dispute Resolution Mechanisms in the European Union

**Issued by the CFE Fiscal Committee  
Submitted to the EU Institutions on 20 March 2020**

### 1. Introduction

CFE welcomes the Commission's intention to expand and improve the mechanisms available to Member States to resolve double taxation disputes with the introduction of Council Directive No. 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union (the "Directive").

CFE commented on this matter in the context of the OECD BEPS consultation process in April 2016<sup>1</sup> and when the proposed Directive on Double Taxation Dispute Resolution Mechanisms was subject to public consultation in May 2017<sup>2</sup>. This Opinion Statement complements these previous opinion statements.

### 2. Background

Double taxation impedes the ability of entrepreneurs operating cross-border to develop their business and consequently decreases the competitiveness of the Single Market. Easily accessible, efficient and effective dispute resolution mechanisms are a crucial element in achieving fair and effective taxation within the Single Market. At present, there are a large number of outstanding cases; in addition, more comprehensive audits by tax authorities are increasing the number of such cases. These developments make the implementation of a properly functioning dispute resolution mechanism crucial.

In general, CFE welcomes this Directive and views it as a positive development. Several aspects which CFE especially appreciates were summarised in CFE's Opinion Statement FC 4/2017 on the proposed Directive on Double Taxation Dispute Resolution Mechanisms in the European Union issued in May 2017, including, inter alia, its extended scope compared to the EU Arbitration Convention, increased efficiency and effectiveness in the process, and higher tax certainty as a result.

Given that the purpose of the Directive is to facilitate resolution of disputes which arise from the interpretation and application of agreements and conventions that provide for the elimination of double taxation, it appears to the CFE that the scope should also cover the EU Directives in the field of taxation, since different application and interpretation of these Directives by different Member States may result in disputes and double taxation. CFE also wishes to draw attention to the fact that the wording of the second sentence of Art. 2(2) may cause difficulties in resolving tax disputes under the mechanisms of the Directive. The wording does not determine the Member State whose laws should prevail in giving definitions to the terms involved. While this article follows closely Art.

3(2) of the OECD Model Tax Convention it is not clear whether the interpretation and guidance provided in the Commentaries to the OECD Model Tax Convention should be, or would be, adopted by the Member States, particularly those that are not members of the OECD.

### 3. Comments on Procedures under Directive

CFE in particular appreciates that the Directive expands the existing mechanisms for taxpayers under previously available possibilities by broadening the scope of disputes that could be settled, streamlining the process and addressing some of the shortcomings. Consequently, CFE considers the Directive to be a positive development.

In spite of the overall positive developments, there are nevertheless outstanding issues that, in CFE's view, merit further consideration. To that end, CFE is setting out its views on the matter hoping that these comments will be helpful in any future revisions of the Directive or in other developments in the resolution of tax disputes.

#### 3.1 Length of dispute resolution process

The positive development for taxpayers and for tax certainty generally is that the Directive introduces a stipulation for the mandatory resolution of income tax disputes subject to a strict and enforceable timeline.

In spite of such a strict timeline, the dispute resolution process under the Directive could still take up to 5 years. Such a length of time for the proceedings, in particular from a taxpayer's point of view, does not represent an *effective* dispute resolution process. If the process under the Directive is reviewed with a view to making changes, it should be amended so the binding resolution is achieved within 2 to 3 years at most.

#### 3.2 Taxpayers' Role and Rights

The Directive entitles the taxpayer to initiate the proceedings. CFE observes that under the Directive, the taxpayers' rights are broader than rights available under other tax dispute resolution mechanisms, such as the MAP procedure or under the EU Arbitration Directive. These additional rights include, for example, that taxpayers will be notified of the terms of reference of the dispute, the proposed timeframe for completion and the terms of conditions of the involvement of third parties.

However, the closer involvement of the taxpayer in the process would increase tax certainty and trust of taxpayers in these types of dispute resolution

procedures. An example could be the taxpayer being entitled to propose or submit evidence, and/or their more active participation in the process.

#### 3.3 Creation of Advisory Commission or an Alternative Dispute Resolution Commission

CFE welcomes the flexibility that the Directive offers in the form of an option between the Advisory Commission or the Alternative Dispute Resolution Commission (the "Commissions"). Such flexibility can simplify and accelerate the dispute resolution process.

One of the crucial elements of an effective and efficient dispute resolution process is transparency in the selection of the persons who are decision makers, i.e. arbitrators or members of committees whose decision will be the basis for final resolution of the dispute.

Therefore, CFE believes that a more transparent process of selection of members of the Commissions should be considered. In addition, the right of the concerned taxpayer to file an objection against the member of the Commission that they consider is not an impartial or independent member could increase the trust of the taxpayer into the transparency of the whole process.

#### 3.4 Lack of Independent Persons of Standing

CFE agrees that any person elected as a member of any of the Commissions should be experienced and knowledgeable, as well as fully independent and impartial from the parties involved in the particular case. On the other hand, CFE notes that the criterion listed in Article 8, point 4 letter (d) is so strict that it could be a serious problem identifying a suitable person in some countries, in particular in those countries where the judges are not allowed to perform activities other than judicial activities. Needless to say, those persons suitable to be members of these Commissions should have solid knowledge in the field of international taxation. CFE therefore strongly suggests reconsidering the necessity of the criterion stated in Article 8, point 4 letter (d) of the Directive.

Additionally, an option to not implement the decision due to a lack of independence should be further considered. Any independence concerns should be raised upon appointment to avoid delays. Since there is no guidance on independence, a wide discretion has been given to national courts. Alternatively, some guidance should be issued in this area.

### 3.5 Dispute Administration Body

Experiences from other dispute resolution forums, in particular from arbitration, show that the dispute resolution process can be more effective and rapid if there is an institution taking care of administration of the dispute resolution process. These institutions could administer the case, send reminders to parties or arbitrators, and share experience of procedural issues based on previous experience.

For the purposes of disputes under the Directive, the Permanent Court of Arbitration could be a suitable institution as it already has experience with administering cases between states.

Such an institution could also maintain the list (either publicly available or not) of persons having necessary skills and experience to act as arbitrators or members of the Commissions. In addition, it could also be considered that such an institution would serve as the appointing body if any party to the dispute were inactive in the selection process.

### 3.6 Form of Decision given by Commissions

Under the Directive, the Commissions reach conclusions and issue an opinion. If the competent authorities fail to reach an agreement as to how to resolve the question in dispute, the opinion of the Advisory Commission or Alternative Dispute Resolution Commission shall become a binding resolution of the dispute. However, the Directive does not provide any formal requirements for this opinion, for example a requirement to set out the reasoning.

Considering this fact, the CFE would welcome a legal requirement to state clearly in the opinions the reasons/arguments which led the Commissions to reach their conclusions. Such an approach would have several advantages. It could: (i) increase tax certainty and the trust of the taxpayer in the dispute resolution process, (ii) decrease the risk that the cases on tax disputes will be subject to political trade, (iii) increase predictability of the results for similar cases in the future and finally, as a result of all these aspects, (iv) could lead to a lower number of tax disputes in the future.

### 3.7 Introduction of Instruments to Stimulate Prompt Decision

Whilst in many cases the tax will already have been

Paid in the first State prior to dispute procedure being invoked, it may be worth considering using the payment of the tax or obligation to pay interest as a leverage to encourage speedy resolution of disputes between tax authorities. For example, the use of escrow accounts whereby the tax would become lodged in an account, which would only become unblocked once there has been a satisfactory resolution of the dispute. The sum should be limited to the highest amount of tax which may become due in order to avoid double taxation.

### 4. Parallel Mechanisms

Currently, a dispute involving the interpretation of double taxation treaties can be solved in several forums using the various dispute resolution methods available. On one hand, the introduction of the new instrument is welcome as it brings another possibility which a concerned taxpayer could consider using to defend its rights. In particular, the CFE believes a broader and more flexible approach to the form of alternative resolution procedure which can be applied will greatly improve the process for both the competent authorities and the taxpayer.

On the other hand, the multiple means of resolving disputes available in this field of tax law increase opacity and uncertainty.

Briefly, the following dispute resolution instruments are available:

i) National legal remedies are generally not very effective when dealing with double taxation disputes on the basis that national courts do not have jurisdiction to rule on the levying or reduction of taxes in another jurisdiction. Therefore, the inability to bind the other jurisdictions in cases of double taxation results in the taxpayer not getting an effective remedy before the national courts. In addition, it is common practice that domestic law prohibits tax authorities from deviating from the decisions of national courts. Therefore, any decision arrived at under another mechanism contrary to the decision of a domestic court may be rendered ineffective in practice.

ii) The Mutual Agreement Procedure derived from Article 25 of the OECD Model Tax Convention. MAP entitles the tax authorities negotiating an agreement to cancel the double taxation; the taxpayer is not a party to the proceedings.

<sup>2</sup> Opinion Statement FC 4/2017 on the proposed Directive on Double Taxation Dispute Resolution Mechanisms in the European Union, May 2017, available on the CFE website:

[http://taxadviser.europa.org/wp-content/uploads/2018/05/CFE-Opinion-Statement-FC.04.2017-on-Dispute-Resolution\\_0.pdf](http://taxadviser.europa.org/wp-content/uploads/2018/05/CFE-Opinion-Statement-FC.04.2017-on-Dispute-Resolution_0.pdf)

<sup>3</sup> See [https://ec.europa.eu/taxation\\_customs/news/statistics-apas-and-maps-eu\\_en](https://ec.europa.eu/taxation_customs/news/statistics-apas-and-maps-eu_en)

Under the majority of tax treaties, countries are only required to “endeavour to resolve” the dispute, so in many cases no agreement is reached and the double taxation remains outstanding. This could be alleviated in a limited number of tax treaties by a provision for mandatory binding arbitration at the request of the taxpayer if agreement has not been reached within 2 years of the presentation of the case (inserted into the OECD Model Tax treaty in 2008 and to be introduced through MLI implementation).

iii) The EU Arbitration Convention provides for mandatory binding arbitration, but only in relation to transfer pricing related disputes which satisfy three preconditions. The taxpayer has three years from the date of the impugned notification to invoke the procedure. If the authorities fail to reach agreement within 2 years, mandatory binding arbitration is invoked. An advisory commission is set up with both tax authorities represented; a decision is reached within 6 months.

iv) The Directive provides several alternatives of how to reach binding resolution. The taxpayer can initiate the dispute resolution process within 3 years from the receipt of first notification. The competent authorities have 6 months to determine whether to accept the complaint (subject to the provision of outstanding information) and a further 2 years to resolve the double taxation by means of the mutual agreement procedure (this period can be extended by one year). In the event that the Member States fail to reach agreement to eliminate double taxation pursuant to the MAP procedures, the Advisory Commission or the Alternative Dispute Resolution Commission is established and issues an opinion. The competent authorities are not bound by the opinion of either of the Commissions, however, if they do not reach an agreement on an alternative conclusion within six months, the opinion becomes binding.

Although all these aforementioned existing procedures were introduced with an aim to assist taxpayers in mitigating and redressing the effects of double taxation, their parallel existence creates the question of which is the most appropriate procedure for the taxpayer to initiate and increases tax uncertainty.

Consideration should be given to the practical implications for taxpayers and tax authorities of parallel arbitration/MAP procedures/procedure under the Directive being available to the taxpayer to invoke. The Directive does not address how to resolve parallel

Proceedings that could arise in practice (though some issues are dealt with in Article 16 of the Directive).

In theory, Member States should seek to achieve a satisfactory outcome for the taxpayer; in reality, however, a conflict of interest can arise for the Member States in the negotiating process. Under the present system, negotiations do not take place on a legal level but more on a political level in the sense that they take place between the tax authorities.

Consequently, problems arise in relation to legal certainty and the effectiveness of the process, particularly for the taxpayer. All the aforementioned dispute resolution procedures (in particular the MAP) are costly and time consuming and the outcome of the procedure is extremely uncertain for the taxpayer. CFE notes that from the taxpayer’s perspective, the aim of the procedure is not solely to resolve the double taxation but also to clarify the nature and extent of the taxing rights of the different jurisdictions as guidance for its future activities. A decision stating clear reasoning for the outcome is therefore imperative for development of cross border business activities.

## 5. Extension of Scope for Other Tax Fields

A crucial element of the Directive in comparison to the EU Arbitration Convention, which is limited to transfer pricing, is the extension of the scope of relevant disputes covered to all cross-border double income taxation issues.

However, for the competitiveness of the EU Single Market it will be crucial to introduce additional instruments and mechanism for the avoidance of double taxation, which are not limited to income tax disputes. CFE therefore fully supports any initiative to introduce techniques for avoidance of double taxation and for dispute resolution for other taxes such as for example VAT, inheritance tax, donation tax or insurance tax.

Finally, due consideration should be given to the possibility of extending the existing mechanisms to double tax disputes arising from unilaterally introduced digital services taxes (DST) around the EU. DST are not income taxes, but revenue or turnover taxes. It is widely accepted in academic literature that turnover taxes do not fall within the scope of the OECD Model and tax treaties. Considering that revenue or turnover taxes are substantially similar to indirect taxes, they do not qualify for treaty relief.



Specifically, if a tax is not a 'covered tax' under Article 2 of the OECD Model Tax Convention, it would consequently not be covered by either the 'distributive' articles of the OECD Model, nor would it qualify for dispute resolution under the Mutual Agreement Procedure (MAP) of Article 25 of the OECD Model. Accordingly, such indirect taxes would not qualify for relief from double taxation under Article 23 of the OECD Model in the residence jurisdiction of the taxpayer, and inevitably result in double or multiple taxation.

A key policy consideration in a situation in which a tax (for example, DST) is not a covered tax for tax treaty purposes is the inability of a taxpayer to claim double taxation relief, which is a point considered in the future revisions of this Directive.

The CFE hopes that these comments will be helpful in any future revisions of the Directive or in other developments in the resolution of tax disputes.

CFE Tax Advisers Europe is the European umbrella association of tax advisers. Founded in 1959, CFE brings together 33 national tax institutes, associations and tax advisers' chambers from 24 European countries, representing more than 200,000 tax advisers. CFE is part of the EU Transparency Register no. 3543183647-05.

We would be pleased to answer any questions you may have concerning our Opinion Statement. For further information, please contact Stella Raventós-Calvo, Chair of the CFE Fiscal Committee or Aleksandar Ivanovski, Tax Policy Manager at [info@taxadviserseurope.org](mailto:info@taxadviserseurope.org). For further information regarding CFE Tax Advisers Europe please visit our web page <http://www.taxadviserseurope.org/>

# FRANCE and USA

## COVID – 19 Drives CFO optimism to all-time low

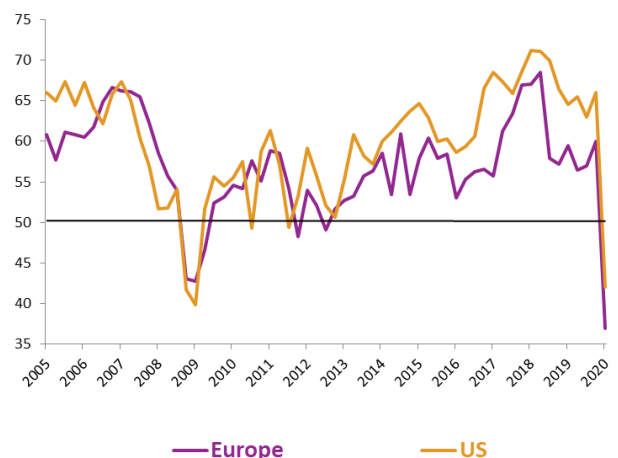
By John Graham, D Richard Mead Jr. Family Professor of Finance,  
The Fuqua School of Business, Duke University and  
Philippe Dupuy, Associate Professor, Accounting, Law and Finance,  
Grenoble Ecole de Management

IAFEI AND A GROUP OF PARTNERS AMONG WHICH DUKE UNIVERSITY AND GRENABLE EM SURVEY CFOs ACROSS THE WORLD. FOR THE FOURTH QUARTER 2019, THE SURVEY WAS RUNNING FROM 25<sup>TH</sup> FEBRUARY TO 3<sup>RD</sup> APRIL 2020.

- The new coronavirus drove CFO business optimism to an all-time low over the two weeks ending April 3.
- The results document the week-by-week impact of COVID-19 on businesses around the world.

The CFO survey has been conducted for 96 consecutive quarters and spans the globe, making it the world's longest-running and most comprehensive research on senior finance executives. Results are for the U.S. unless stated otherwise.

CFO survey: Optimism index



### Business Optimism Index

The CFO Optimism Index fell to 42 (on a scale from 0 to 100) in the second half of March, which is more pessimistic than at the depths of the 2008 financial crisis.

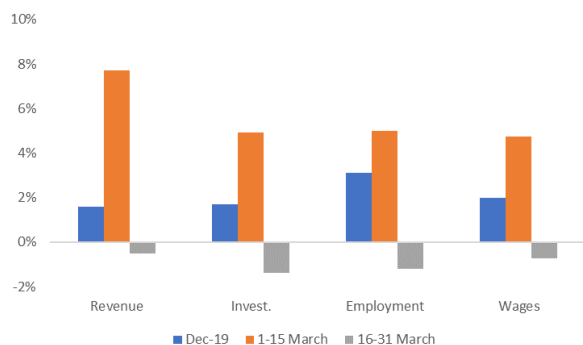
The Optimism Index was at 58 in the first half of March before plummeting to the low 40s in the second half of the month. The index has proven to be a good predictor of future GDP and unemployment, suggesting that the economy will perform more poorly in 2020 than during the Great Recession.

We have already seen a bigger jump in unemployment in the two weeks ending April 4<sup>th</sup> than during the entire Great Recession, so there is good reason why optimism has fallen. CFOs are fighting their own war for the survival of their companies.

### Spending and Hiring Plans

The dramatic drop in the Optimism Index indicates that CFOs were surprised by the large and sudden effects of the new coronavirus on business prospects. Prior to March 15, U.S. businesses planned to increase payrolls by more than 4% and increase spending by nearly 5%. After March 15, they plan to reduce employment by 1.2% and reduce spending by 1.4%.

## 12-month forecasts before/after mid-March in the US



Things could get worse. Even with the pessimism expressed during the second half of March, only about one-third of U.S. firms believed that they face large financial risk due to COVID-19, while about half said they faced medium risk. Should more companies realize that they in fact face large financial risk due to the virus, hiring and spending numbers will get even worse.

The survey asked CFOs about their revenue forecasts in a “very bad” scenario. Sales revenues are expected to fall by 13.3% in a very bad scenario, as compared to a 1.4% reduction in the most likely scenario.

### Global Optimism

As noted, U.S. optimism before/after March 15 was 58/42 on a scale of 0 to 100. In other regions of the world, the Optimism Index after March 15 also fell to or near all-time lows: Europe (50/35), Latin America (59/42), and Africa (57/37). In Asia (44/39), optimism was already low before March 15, consistent with parts of Asia already feeling the effects of the new coronavirus.

### Average global business outlook

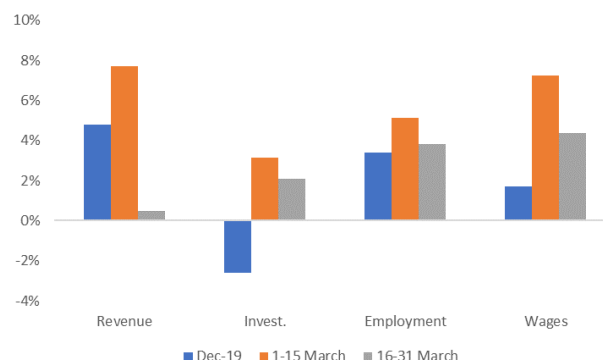


GDP weighted Average Global Business Outlook  
(World Bank GDP constant prices in USD)

## 12-month forecasts before/after mid-March in Europe



## 12-month forecasts before/after mid-March in Asia



About the survey: The Duke University/CFO Global Business Outlook survey has been conducted for 96 consecutive quarters. The survey period ended April 3rd and generated responses from more than 1200 CFOs, including more than 500 in North America, 78 from Asia, 164 from Europe, 437 from Latin America and 46 from Africa. For more information: [philippe.dupuy@grenoble-em.com](mailto:philippe.dupuy@grenoble-em.com)



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DUKE CFO GLOBAL  
BUSINESS OUTLOOK



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## The government's taxation response to the COVID-19 pandemic

by **Filipa Correia**, Chair of the IAFEI International Tax Policy Working Group and by **Alessandro Valente**, Vice-Chair of the IAFEI Ethics and Sustainable Development Working Group

*The article aims to analyze the new OECD's report, released on the 15<sup>th</sup> of April 2020, which explores the tax and fiscal measures introduced by governments in response to the COVID-19 outbreak and the future challenges that countries will face from a tax standpoint. The final remarks of the OECD's report emphasize that, to look ahead and recover from this economic crisis, it is necessary to invest on the multilateral cooperation among countries. Tax cooperation will be crucial to address the tax challenges brought by the digitization in the economy, to ensure support for developing countries and to construct new tax measures which will be able to restore both the public finance and the enterprise's financial position. Lastly, the article summarizes the main measures introduced by the Italian Government to support businesses.*

**Keywords:** COVID-19; Economic downturn; Recovery from the crisis; Multilateral collaboration; Digitalization of the economy.

### 1. OECD report: tax policy responses to COVID-19

As stated by the OECD, the COVID-19 outbreak has caused untold human suffering and major economic disruption.

The world is witnessing the impact of COVID-19 on the economic activity, global supply chains and profitability across most industries. Such an unprecedented context is raising numerous tax issues.

As such, it is imperative to understand which impact may be exacerbated in the coming weeks from a fiscal standpoint and assess whether the tax measures that were previously provided by governments are sufficient to help businesses, support households and preserve employment.

To that end, on the 15<sup>th</sup> of April 2020, the OECD released the “*Tax and Fiscal Policy in Response to the Coronavirus Crisis: Strengthening confidence and Resilience*” report, which provides a wide-ranging overview of the efforts made by governments in response to COVID-19.

The report focuses on the tax policies already employed by governments who are facing the COVID-19 crisis, including a brief analysis on the economic and fiscal future challenges that may arise as a result of the pandemic.

Governments are already taking decisive action to swiftly and forcefully overcome the economic impact of coronavirus to protect the incomes of social groups and businesses during the virus outbreak. However, there is still much to be done, considering that the OECD estimates suggest that for each month of containment there could be a loss of 2% of annual GDP.

The OECD observed that, for a full tax recovery from the crisis, it is necessary for governments to act together, in order to:

- avoid that tax disputes may trigger trade wars;
- consider, under a multilateral collaboration approach, the possibility of revamping old tax tools or introducing new ones;
- address the tax challenges connected to the digitalization of the economy.

If containing the epidemic and limiting its severity is the priority from a health emergency standpoint, it is also equally important to lead the majority of the taxation systems towards a coordinated taxation policy response, in order to help workers and industries worldwide, particularly with regard to SMEs, which are inherently less prone to benefit from implementing “social distancing” measures.

As such, the coronavirus pandemic is taking a particularly heavy toll on SME's, which are suffering from a reduction of both supply and demand.

The latest OECD's report, which describes how tax and policy can “*cushion the pandemic's impact*”, outlines the most relevant policy reforms that will be needed to prepare for the recovery of public finances and does so by identifying 4 main aspects:

- detecting the short-term fiscal measures that countries have introduced in response to the COVID-19 crisis;
- investigating the ways in which short-term measures are performing;
- suggesting new fiscal policy measures that might be needed to ensure economic recovery after the health crisis, such as focusing on the fiscal stimulus and strengthening resilience;
- outlining options that could be explored by governments to increase revenues once the economic and health crisis has passed.

According to the OECD's report, governments should increase international cooperation in response to the pandemic, since the individual fiscal dilemmas that countries are facing today against the virus suggest that a shared taxation plan is indeed required.

## 2. Providing valuable business support and strengthening cooperation

The coronavirus outbreak from a health perspective is causing large-scale loss of lives. From both an economic and financial standpoint, the pandemic has initiated the third largest disruption of the 21st Century, after 9/11 and the Global Financial Crisis of 2008.

As such, governments and international organizations are called to develop effective and targeted policies to promptly overcome the crisis. In this respect, it is important to implement tax arrangements that can:

- mitigate the cuts in consumption, caused by the direct effects of containment measures on individuals' spending;

Provide liquidity to support businesses, in order to counteract the severe loss of revenues that might cause many enterprises to terminate their activity or file for bankruptcy.

As a result, the OECD report stated that multilateral collaboration is “*vital to increase the effectiveness of countries' responses at all stages of the path*” and to support developing countries that are facing the pandemic with “*weaker healthcare systems (...) and smaller scope for fiscal and monetary policy*”.

By predicting that the downturn could cut the global economic growth in half and plunge several countries into a recession, the OECD warned that the governments' policy response must to be rapid and uncompromising.

In order to avoid more severe consequences, many governments, have already made important efforts to help businesses and workers by adopting a range of favorable tax measures. These measures include extending the deadlines for tax filling, the deferral of tax payments, the provision of faster tax refunds and certain tax exemptions.

According to the OECD, “*the unprecedented nature of the crisis is prompting a reflection on whether some new tax measures could be contemplated and more traditional ones could be reconsidered*”. To that end, at an early stage, fiscal stimulus measures may represent an effective response to the economic downturn and, subsequently, they could allow, along with other tax policies, to alleviate the costs of the crisis over time.

Furthermore, the OECD has observed that it is now necessary to encourage and redouble the efforts to achieve an early consensus among the Members of the “Inclusive Framework” regarding the revision of the profit allocation rules and to address the specific challenges related to the digital economy, as enclosed in Pillar One and Pillar Two issues.

Hence, to strengthen the resilience of governments' economic and health systems, the OECD has outlined a strategy that illustrates four economic phases of the crisis:

- *phase 1:* Governments have to react promptly to limit the hardship caused by the direct effects of containment measures and respond via targeted tax measures which translate in financial and economic support to businesses;
- *phase 2:* due to the extension of the containment measures, governments have expanded the set of policies previously implemented, adapting them to the changing nature of risk and allowing the deferral of tax payments;



- *phase 3*: during this phase, while the containment measures have ceased, the governments should provide a fiscal stimulus in order to support investment and consumption, promoting an initial recovery;
- *phase 4*: once the recovery stage is reached, countries should consider a long-term plan for fiscal sustainability in order to strengthen the resilience of the economic systems

One of the crucial aspects that the OECD has identified to overcome the downturn is to support businesses by ensuring that they possess enough cash flow and to support investments and consumption.

As indicated in the report, many enterprises are experiencing a “*sharp decline in liquidity*” and they are encountering many difficulties to pay wages, rents, suppliers, interest on debt and taxes. To that end, governments have alleviated cash flows by introducing the deferral of taxes, social security payments, debt payments, rents and utility payments, the deferral of advance corporate income tax, personal income tax, value added tax and social security contributions.

Although initially effective, these measures may not be sufficient, as the global economic crisis will quickly lead to a substantial decline in government revenue by impacting the gross domestic product (GDP) of numerous countries.

Therefore, it is advisable to set up preventive arrangements against taxpayers’ non-compliance, as this may represent one the main factors that could cause such a decline in GDP.

In fact, the global economic crisis brought by the COVID-19 outbreak, causes major challenges for tax administrations, since during the economic downturn taxpayers’ compliance tends to worsen considerably. Taxpayers’ non-compliance may take various forms as individuals and businesses may:

- engage in taxable transactions without registering them with tax authorities;
- fail to file their tax returns by the end of statutory filing deadline;
- underreport their tax liabilities;
- illicitly claim tax refunds;
- underpay the taxes (tax arrears).

To that end, tax agencies should use the financial crisis as an opportunity to engage in a more cooperative relationship with financial institutions and to provide assistance to those taxpayers that may be particularly affected by the crisis.

On the other end, Tax Authorities should invest in support measures, in order to help taxpayers to cope with their obligations and to develop a toolbox of countermeasures against the cash shadow and the plague of non-compliance, by providing instead, targeted assistance, especially for those taxpayers who have demonstrated to be compliant in the past.

### 3. Recovering from the crisis

In the 4<sup>th</sup> and 5<sup>th</sup> section, the OECD Report examines the way in which governments could overcome the health crisis and may be able to recover from the economic downturn.

As observed by the OECD, it is necessary for policymakers to create the appropriate conditions necessary to strengthen consumption and investments with the provision of different stimulus packages for each country, depending on the size of the “*output gap that results from the crisis*”.

The negative impact on revenue may result from a number of factors, specifically, the income tax collection is expected to decrease due to:

- a slow-down in economy activity;
- a reduction in consumption due to the loss of confidence by consumers and the containment measures applied;
- a fall in the tourism and travel sectors.

In such a context, governments should refrain from introducing taxes. Instead, they should develop a wide range of new economic policy measures in order to restore the current tax landscape and raise revenues from new (or under-used) tax bases.

For instance, the increase in the usage of digital services and the need to raise more revenue from the digital economy could incentivize governments in reaching an international agreement on Pillar One and Pillar Two.

The OECD highlights that, after the crisis, the demand for the implementation of the Globe proposal under Pillar Two will be higher and, at this stage, it is essential to work together in order to avoid the risk that States, individually, may conduct unilateral actions in the digital taxation sector which could lead to trade wars.

The implementation of the Globe proposal, which ensures that the profits of MNEs are subject to a minimum level of taxation, will be necessary to guarantee an effective taxation between the main multinationals and SMEs, which could suffer greatly from the consequences of the COVID-19 crisis. According to the OECD,

It is now essential to agree upon a common program in order to create a tax system capable of restoring public finances, sharing the burden in a more equitable way, disincentivizing the use of coal and encouraging environmental policies.

#### 4. The Italian response to COVID-19 outbreak: tax implications and fiscal incentives

The Health emergency that Italy is facing, is generating a significant local economic impact.

Almost all Italian enterprises are witnessing the impact of COVID-19 on their economic activity, global supply chains, and profitability and, it will most probably affect the way in which the enterprises diversify their sourcing activities.

In such a context, it is essential for Italian SMEs to implement strategies that allow them to preserve the health of their business while facing the negative effects brought by the COVID-19.

To that end, to provide a prompt response to the tax implications, it is necessary for enterprises to adopt strategies that will allow them to protect their assets' value. This can be done by employing the measures set by the Italian Government with the "Cura Italia" decree (Decree No. 18/2020) and with the so-called "Liquidity Decree" (Decree No. 23/2020) in support of businesses.

The Italian Government is adopting a range of fiscal stimuli, which include tax concessions, incentives, and rebates.

With Decree No. 18/2020, Italian Government has provided:

- the suspension of payments of withholding tax and social contributions for individual taxpayers;
- the possibility for SMEs to take advantage of public financial support measures that is up to 33% of the loans granted, and to have access to a special SME guarantee fund.

Furthermore, the "Cura Italia" decree has suspended VAT payments for tourism enterprises, travel agencies, sporting clubs and associations, entities managing sports facilities, entities managing theatres, cinemas, to cite a few.

Moreover, with Law Decree No. 23 of 8 April 2020, the Italian Government has introduced urgent measures to support companies in having access to liquidity and financing, to grant specific powers in certain sectors and to strengthen employment levels, as well as measures regarding the postponement of selected tax obligations.

To that end, the "Liquidity Decree", is to be read in connection with the "Cura Italia" decree, which provides

measures (which apply to entities with a tax domicile or registered office or location of business in Italy) regarding:

- the access to credit and tax compliance for businesses and measures in the health and labor sectors;
- the extension of administrative and procedural deadlines and special governmental powers in strategic sectors.

The "Liquidity Decree" has also suspended all payments due in April and May 2020 (Art. 18 of the Liquidity Law Decree). As such, VAT, withholding taxes on wages, social security and welfare contributions payments expiring in April and May 2020 are on hold for business activities who started their activity after 31st March 2019 and for business activities with an overall turnover:

- up to €50 million in the last fiscal year, whose monthly turnover in, respectively, March and April 2020 has decreased by 33% compared to, respectively, March and April 2019;
- higher than €50 million in the last fiscal year, whose monthly turnover in, respectively, March and April 2020 has decreased by 50% compared to March and April 2019;

In particular, the suspended payments must be made by 31 June 2020 in full, or in five equal installments starting from June 2020, without penalties and interest.

Furthermore, the main provisions from a taxation standpoint that have been established by the Government in the "Liquidity Decree" are the following:

- the deferral of the withholding for self-employed workers;
- the suspension of the deadlines relating to the activities of the offices of the tax authorities;
- the suspension of the hearings and tax litigation;
- the extension of payments to the public administration that were due the 16<sup>th</sup> of March 2020 and deferred to the 20<sup>th</sup> of March 2020 (and can be paid until 16<sup>th</sup> April 2020 without any penalty or interest).



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## What Mexico will give to the world after COVID 19

by **José Jaime Díaz González de la Campa**, Member of the  
IMEF's Board and Independent Consultant

Mexico has been hit like everyone else by the pandemic. This is not my topic in this article. I will only focus on mentioning that situations not foreseen and not controlled by anyone, make us strengthen ourselves as a country.

Shortly before the pandemic began, international markets were in high gear due to the potential trade conflict between the United States and China. On the other hand, the conflict over the oil supply has generated a double impact on the export prices of a barrel. The lack of demand for energy derived from the fact that world economies have stopped, and the excess supply derived from increases in production in Russia and Saudi Arabia.

For its part, Mexico has reduced its oil extraction to 40% and now it is necessary to import gasoline and other finished products for different industries, so on the balance sheet we are already net importers of petroleum products.

In the short term, this has been negative for our country, since the state-owned company PEMEX has lost competitiveness in the cost of oil extraction, but in a broader sense, that creates an opportunity to transform our energy generating industry into new ones. cleaner technologies. Currently there is a political issue within our country on this issue.

Mexico's location south of the world's largest market makes it a unique and privileged place to grow its business relationship with the United States. Mexico is now the number two trading partner with a surplus of 100 B USD at the end of 2019. China has a surplus with the United States of 345 B USD in the same period of time.

Mexico's trade potential with the United States still has great room for growth, considering the potential conflict between the United States and China.

On the other hand, the signing of the trade agreement "USMCA" between the United States, Canada, and Mexico will cause the exchange of inputs to be concentrated in this region, generating potential for additional openness.

For Mexico it is a great opportunity, however, currently 80% of exports are directed to the USA. If under the same concepts, exports of intermediate-use goods are reviewed to other countries with which Mexico has trade agreements, the export potential may be increased.

What products can be exported, agricultural products and other raw materials. Minerals, precious and industrial metals. Intermediate goods, such as IT services.

We have learned with the pandemic that Mexico with its professionals is capable of exporting knowledge in different areas, and finding in technology the means to transmit it.

There are different models for managing services remotely, such as financial services, consulting, control of computer systems and the creation of new content. E-commerce is an example where it has not been adopted in the local market at the same level as the international one. In other countries, there is already a widespread concept of online shopping and cashless transactions. The use of electronic money in our country and in many others is still a dream of the future.

However, in Mexico, technology is being developed so that the supply chain of different basic products is technified, traceability is obtained and, best of all, transactions are cashless. Various initiatives, have already caught the attention of authorities in Mexico and Latin America. This model could be exported to a large part of countries where their supply chains are still poorly technical and become more expensive through intermediaries who, in some cases, do not add value.



The traceability of products is already a requirement in several markets such as in Europe and in the United States. In Mexico it is still not a requirement, and rather it is offered as a competitive advantage. When the complete chain is within the same platform, not only producers and distributors are integrated up to the final consumer, but also providers of transport services, fertilizers, warehouses and many other services that add value in the chains.

Being also an open platform, it is not restrictive, but inclusive. Technology providers that add value can connect and also obtain information that is useful for their own services.

This is just one example of what is currently developing in Mexico. The private sector and NGOs are the ones who have taken the lead. The Government is so far open to listen to and support these initiatives.

It is worth mentioning that these developments will obtain a lot of information known as “big data” that will serve multiple secondary purposes. For now, the central purpose is to improve the food supply chains in the country.

This is one example of what Mexico will give to the world in the short term, so stay tuned.



**José Jaime Díaz González de la Campa**  
Member of the IMEF's Board  
& Independent Consultant

# SOUTH AFRICA

**Worldwide the airline and travel industries are currently in free fall and SAA's interim CFO will need to steer the state-owned entity through the perfect storm.**

CFOTalks is the online publication of the Southern African Institute for Business Accountants (SAIBA) a full member of IAFEI. CFOTalks interviews high level CFOs and share their insights with the CFO community.

Interview with Deon Fredericks, interim CFO South African Airways (SAA). The interview was made by Ciaran Ryan. The interview is available as a podcast at [www.cfotalks.com](http://www.cfotalks.com).



**CIARAN RYAN(SAIBA):** SAA is in difficult times at the moment and this is one of the reasons we wanted to talk to you. It is, in fact, under business rescue as we speak. So you have got some bosses that are sitting above you but just to set the stage here a little bit, you joined SAA in 2017 when it was already in pretty dire straits, before that you were the CFO at Telkom. I guess the question is, why did you go to what looks like a sinking ship at SAA?

**DEON FREDERICKS:** It's an interesting question, at that stage my boss, Siphosiso Maseko, asked me if I would be interested, as he was approached by the minister to look for management and leadership skills that can be utilised in the SOCs, state-owned companies, in general. So ultimately I thought about it and at this point in my life I would like to give back, I am involved in various initiatives as well to give back to not only the

Industry that I am in but also to South Africa because I think all of us need to contribute to a lesser or greater extent. After I thought about it, I thought that it would be a good challenge. One of the things that Telkom has always been every year, as you would know, it was quite different, so there was never time to get bored. Ultimately I am a person who is a workaholic and I thought this would be a good challenge to try and make a difference because, as you know, the SAA brand is actually a very good brand, with all its challenges it is probably the fourth or fifth well-recognised brand in the world.

**CIARAN RYAN:** That's interesting, I do have a high opinion of SAA having flown it many times, just in terms of the quality of the service compared to some of the airlines that I have flown elsewhere in the world and I always felt that it would be a terrible pity to see that disappear. So for people who are overseas and who don't know, just give us an extent of the financial damage that you surveyed when you moved in there in 2017, what was the scene on the ground?

**DEON FREDERICKS:** Look, they were in a very challenging position at the end of the day and one of the key challenges was funding. As you know, if you have a company making losses and you don't have funding it's very difficult to operate on a drip feed basis. So my key focus in the last, and probably still now, was to make sure that we have sufficient funding to operate

Because if you don't have sufficient funding then suddenly you need to decide what is a priority. So you only address issues of today, you can't really plan forward in terms of initiatives that you want to implement and from a capital investment perspective, you would delay certain initiatives that would be critical for the future of the airline. So it's been quite challenging. I think on the other side is what they called the long-term turnaround plan, which I think is a good plan, it had various elements. I will share the key elements with you, the first one was liquidity and funding to ultimately get the balance sheet in shape to support the organisation and to grow the organisation going forward. The second part was in terms of revenue stimulation and that also includes making sure that you have the right fleet because in this industry if you don't have the right fleet you may have very high load factors but you will not make money. Just to put it in context, if you look at the margins in this business it's probably 4% to 6%, so you need to make sure that you co-ordinate focus and align so that you are able to be profitable in this environment. The third part was our technical environment that we had to reshape, refocus and making sure...because the key for them is to make sure that they provide aircraft so that the airline can be on time, so the turnaround time is critical and, as you know, unfortunately with state capture some of those processes were completely broken, the relevant expertise has left the organisation, so it is to a great extent a rebuilding. But the challenge always in a situation like this is not like a green field, in a green field you can start and say this is what I am going to focus on, this is what I will do, these are the people who I will bring in. Unfortunately, you have a legacy organisation and to change certain things is very challenging. I think just from my perspective the biggest challenge within the organisation, and even when we started the turnaround at Telkom, was culture and culture doesn't change over a year or two years, it takes at least four to five years, and similar in the South African Airways environment and you have various stakeholders, this is one of the organisations that you need to deal with in order to make sure that you are aligned and inform - and we could have done better in terms of communication - inform all stakeholders because there were some stakeholders that believed that government will always bail us out and didn't understand the bigger macro environment that government, firstly, is not in a position to bail us out and we need to make sure that we are effective, efficient and provide a reasonable service at a reasonable price to be competitive. The whole focus a full-service airline and a low-cost airline, your normal person in the street doesn't see the difference.

So if you are significantly more expensive because of your cost base, you will struggle to increase your load factors.

### R46 billion bailout

**CIARAN RYAN:** How much has the government provided in terms of bailout funds over the last decade, the last figure I saw was about R13 billion?

**DEON FREDERICKS:** No, if you look in the last five or six years it's probably about R30 billion.

**CIARAN RYAN:** R30 billion and now the taps are closed.

**DEON FREDERICKS:** What government has indicated, as you would have seen in the budget, is that they have provided R16.4 billion to pay the legacy debt. They have also indicated within the budget that they will fund the implementation team, which the BRP will put in place from the budget. The shareholder has now confirmed that they are fully aligned up to the president and that they want to make sure that we make a success of the airline. So it's key that all stakeholders actually take hands and make sure it works. That's the only way it will work.

**CIARAN RYAN:** That R16.4 billion, is that included in the R30 billion that you mentioned or is that over and above?

**DEON FREDERICKS:** That is over and above.

**CIARAN RYAN:** So at the end of the day it will be R46 billion.

**DEON FREDERICKS:** Yes, about R46 billion.

**CIARAN RYAN:** That's a huge bailout figure. First of all, did you finish, you were running through the turnaround plan.

**DEON FREDERICKS:** The third one was in terms of organisational design, it means making sure that you have the right organisational structure, the right people in the right positions and the right skills. As you would have seen, the business rescue practitioner has now implemented that with a Section 189 [of the Labour Relations Act], where 4708 people will be impacted. At this stage it will be a consultation and negotiation with organised labour, which can give inputs and proposals, and that will determine ultimately what the final structures will look like but also in terms of the number of people who may be impacted.

**CIARAN RYAN:** Right, so about 4700 people could potentially lose their jobs?

**DEON FREDERICKS:** No, remember, that's the full complement, so part of those people will be impacted.

**CIARAN RYAN:** And it hasn't been decided exactly how many...?

**DEON FREDERICKS:** Because there's a process of consultation taking place at this stage.

**CIARAN RYAN:** Right, which you have to do in terms of the Labour Relations Act.

**DEON FREDERICKS:** That's correct.

**CIARAN RYAN:** Okay and the other pillars?

**DEON FREDERICKS:** The others were in terms of governance, in terms of making sure that we are much more flexible. Unfortunately, as you know, we have to comply with the Public Finance Management Act, where if you take our competitors like Comair or BA doesn't have...so the moment you slow in a market then it would be a challenge. As part of the process of the business rescue practitioner they have received certain exemptions, which will enable them to streamline and accelerate the implementation plan.

#### 84 Contracts identified as irregular or suspicious

**CIARAN RYAN:** Of course, in the middle of all of this, I do want to come back to one or two of these points that you've raised...

**DEON FREDERICKS:** The last one is in terms of procurement, as you know, that's where a lot of state capture, if I can use that word, took place. So that's all being reviewed, aligned and challenged, you would probably have seen that the president made presidential proclamation for 84 contracts that we identified that look irregular and suspicious, and that will enable the Special Investigating Unit to actually investigate it and go into people's personal bank accounts to see if there's been any kickbacks or any involvement. So at least there are some of these things that are continuing but unfortunately these processes take much longer than one would like. But it's critical that a detailed analysis and that there will be full focus on that ultimately.

**CIARAN RYAN:** Right, so these 84 contracts have been flagged as suspicious, have they been suspended and cancelled?

**DEON FREDERICKS:** Look, you can't do that until you have done the full investigation because in certain cases it could be that it's not the case. There are certain red flags that you would look at and only after that then you can conclude on that.

**CIARAN RYAN:** In terms of your last audited results what was the wasteful expenditure or irregular expenditure figure?

**DEON FREDERICKS:** We haven't published for the last two years and as it's not publicly available at this stage I wouldn't like to put it out there.

**CIARAN RYAN:** In previous years did it come up as an issue?

**DEON FREDERICKS:** It's always been an issue and in the different years it has been different amounts. In many cases it's been contracts, like for example at one stage because there was a funding issue the board decided to enter only into six-month contracts, which means that some of that has been rolled and when it gets rolled and not gone through a process of a tender it will be classified as irregular.

**CIARAN RYAN:** Right, so suspicious transactions can go under the table much more easily when you have a shorter-term contract?

**DEON FREDERICKS:** If you have to extend for that period, yes, and your challenge in certain cases is also that it doesn't take a month or two to put an alternative provider in place, which means that in certain cases you will have to extend contracts while you go out on tender.

**CIARAN RYAN:** You must have felt when you walked into this that you were walking into a bomb site?

**DEON FREDERICKS:** Not really, I think if you look at Telkom's history, we have been through significant and many challenges over the years and, as I indicated earlier, every year was different, so many of these things I have experienced previously, which means when you are in this situation you need to keep calm and you need to look at what are really the critical issues and take all the noise away. On the other side how do you prioritise because the challenge when a company is in distress is that the people want to do everything that they have done previously but the challenge is that you can't do the same things and expect a different result. As a result of that the focus was more on what are the practical things that we need to focus on and make sure what are the big drivers that will turn the organisation around.



**CIARAN RYAN:** You also have business rescue practitioners now who are sitting above you, so you have bosses, even though you are the chief financial officer, albeit interim, but you do have bosses ahead of you and they are making the key decisions, for example, on what to do with the fleet. This is something that you and I have spoken about before is the fleet that SAA has and I do want to touch on IFRS 16, where you are having to now account for these perhaps in a radically different way because those are the main assets for SAA, are they not?

**DEON FREDERICKS:** Yes, agreed and I think the significant impact of that would probably be less because we have cancelled certain routes, as a result of that you will have fewer aircraft going forward...

**CIARAN RYAN:** Can you just summarise what percentage of flights have been cancelled?

**DEON FREDERICKS:** I will have to just firm up that number for you.

**CIARAN RYAN:** Roughly speaking.

**DEON FREDERICKS:** As I said, it's round about 30% to 40%.

**CIARAN RYAN:** 30% to 40% less flights and those are obviously the less profitable flights?

**DEON FREDERICKS:** That's the less profitable flights.

### Aggressive advertising campaign

**CIARAN RYAN:** Okay, in terms of revenue stimulation, which is one of the pillars that you identified or that you mentioned a little bit earlier, how does one go about that in an airline, how does one start to stimulate additional revenue?

**DEON FREDERICKS:** The big challenge was, as you would see before we went into business rescue, first we had the strike, which was unfortunate and untimely because at that stage the airline was experiencing significant challenges already and it just pushed us further towards the precipice at the end of the day. The second part was when the reinsurance was withdrawn, which suddenly meant that people would not necessarily buy from SAA or fly with SAA, and Flight Centre also indicated that they are withdrawing. I am happy, and we have announced it previously, that the insurance companies are back, Flight Centre is back, so at least that will assist us in the process, and we

Have seen that there's progress and growth. We have also, as you would have seen, gone aggressively into the market with advertising now, there was the Journey Blitz where you can use 10% of your miles for significant benefit for flights going forward and there was a significant reduction in flights that we've advertised. The unfortunate thing now is the coronavirus, where we have seen many of the conferences cancelled, many of the big corporates putting bans on flying, which immediately will impact SAA. You would probably have seen in the newspapers that Virgin, for example, is flying what we call ghost flights to keep their slots specifically in London...

**CIARAN RYAN:** Basically, empty flights just to keep the slots open.

**DEON FREDERICKS:** To keep the slots, there are discussions going on around that. So from our side we are looking at everything that we can do to stimulate the revenue growth but also on the other side in terms of the business rescue process, very keenly focused on what costs we incur going forward.

**CIARAN RYAN:** It really is a perfect storm, the coronavirus coming on top of all of these other things that you've mentioned and Lufthansa, for example, cancelling about half of its flights. You talked about Virgin Airways with their ghost flights, world tourism has died in the last month.

**DEON FREDERICKS:** Agreed, if you look in terms of the Lufthansa situation, they have indicated that they will have to approach their government to support and assist them and you'll see more and more airlines making these announcements because if they don't have support they will struggle going forward. We are a little bit fortunate but if it's going globally then probably at the end of the day it's not going to make such a significant difference that we don't fly to countries...like we don't fly to the East...

**CIARAN RYAN:** All flights to China cancelled?

**DEON FREDERICKS:** Cancelled, we are not flying to Italy that's on lockdown at this stage, so some of these things will help but unfortunately people will reconsider flying and in the short-term it will definitely have a negative impact on your revenue.

**CIARAN RYAN:** At what point do you reevaluate and say it's safe now to open up flights to China and to Italy?

**DEON FREDERICKS:** For us, we didn't fly to Italy, if there's an opportunity for us in the future and everything is back to normal you will always look at opportunities where there is growth in the market and where you would be able to operate profitably. In terms of the East, that will be the same as well. I think the key focus is to make sure that you have an effective base and a profitable base so that you can get profitable and first start off there. So if you get the base right then you can grow from that because you will start generating working capital and funds to fund growth going forward.

**CIARAN RYAN:** Do you have any sense of what impact coronavirus has had on SAA's revenue at this point?

**DEON FREDERICKS:** Look, it's difficult, we are trying to quantify it but it's a difficult situation at this stage. As I said [a couple of weeks ago] we were reasonable, not so much impacted but I think as this thing has now expanded, as corporates are taking action it will definitely have an impact going forward.

**CIARAN RYAN:** For example, in terms of your occupancies on flights, are you seeing a decline on that, on the international flights, even if it's to London?

**DEON FREDERICKS:** Ja, you would see that because of the impact.

**CIARAN RYAN:** Are you discounting seat prices to try and fill them up?

**DEON FREDERICKS:** We will discount to a certain extent, but you need to be careful that you need to at least recover your variable costs at the end of the day.

#### Where to from here for SAA?

**CIARAN RYAN:** Where to from here for SAA, if you lay out the path for the next six months, what do you see happening and will you be staying through this whole business rescue process, which I imagine could last some years?

**DEON FREDERICKS:** It will take time, it's difficult for me to comment what the business rescue practitioners will finally do but the process is that ultimately they will, as they have indicated, put a plan to creditors by the end of March, the creditors will then vote on that and then the plan will be implemented. Depending on the plan, there will be certain milestones that need to be reached at which stage and at what stage the business rescue practitioner will say okay, SAA is in

Good order, in a good state and based on that normal operations can then continue from a board and management perspective. But it's important to say that management and the board is using and working with the business practitioner.

**CIARAN RYAN:** One of the big issues, of course, is the negotiations with the trade unions that have to happen in terms of the Labour Relations Act, there was a strike late in 2019, that calmed down, I think it only lasted for about ten days or two weeks and then it calmed down. How is that relationship with the trade union and are you involved in that?

**DEON FREDERICKS:** I am not directly involved, it's being managed through the business rescue practitioner. Unfortunately, some of the unions have different agendas that doesn't really take the airline forward. As I have indicated previously, we need to take steps now to at least make sure that we save the airline and afterwards we can address any other outstanding issues and concerns that the unions may have. But ultimately this is being dealt with, with the business rescue practitioner at this stage.

**CIARAN RYAN:** Right, what do you say to those people who say SAA has sucked too much money out of the Treasury, R30 billion plus another R16 billion to come, that it should be allowed to just fold up, it's gone to far.

**DEON FREDERICKS:** I think sometimes it's easy to stand outside, it's like when you watch a soccer game, you sit on your chair there and you play better than the players...

**CIARAN RYAN:** Yes, I always felt I'd make a great Springbok coach [laughing].

**DEON FREDERICKS:** Agreed and sometimes people don't have all the information but ultimately it will have a significantly bigger impact than SAA. The key is if you look at all the implementation plans there was never anything wrong with the implementation, the elements as I shared with you previously is mostly the same, with some small changes. But ultimately it was all about implementation, getting the right skills in place, making sure that you are flexible, governance processes that you can make decisions quickly, making sure that you reshape the organisation, addressing the technical part of the organisation and strengthen the sales part, which is critical in an airline.

## **SAA a clear target for state capture**

**CIARAN RYAN:** If you read the press, SAA was a clear target for state capture over the last decade and under then chairwoman Dudu Myeni it seems to have just fallen off the edge of a cliff completely. I think you came a little bit after her time or during her time?

**DEON FREDERICKS:** After her time.

**CIARAN RYAN:** Okay, so this is not something that you had firsthand experience of. Do you think SAA will survive?

**DEON FREDERICKS:** SAA can survive, I think there's a reasonable plan on the table, it's for all the stakeholders to work together and not against each other. Unfortunately, as I said, there are various agendas with various stakeholders and currently the business rescue practitioner is driving it, and if he manages it in accordance with normal business practices it can be a successful company again. Some difficult decisions will have to be taken and if these decisions are taken, then SAA will survive.

**CIARAN RYAN:** I guess it's one thing to be a chief financial officer in an organisation that is solvent but quite another when you're relying on state support the way SAA has. This is like a Telkom, you have a functioning business, you have a business that has got positive cash flow, but you come to SAA and it really is quite something. This is a great thing to add to your CV, to go into a bomb site and fix it up. If SAA is turned around, and hopefully that is the case, this will be a hell of a feather in your cap as a CFO. This is an unusual job for any CFO.

**DEON FREDERICKS:** I agree and I think one needs to look a little bit bigger in the context if you look currently at how many of the companies are in distress or challenging, good companies, and the belief is always that you need conservative CFOs in organisations, you need to put something away for a rainy day and you must make sure that you plan for the worst and hope for the best, and sometimes you need some luck as well. So I think in SAA's case we need to do the right things quickly and urgently, and if you can do that you will survive. Is it a challenging environment, yes ultimately the role of the CFO has become significantly more to get involved strategically and, as I always say, any action within an organisation has a financial impact, so having overall responsibility for finances you need to make sure that you are on top of that. Sometimes in an organisation it's not so easy

In that the culture was that we don't include finance to look at some of these decisions and understand what the implications will be.

**CIARAN RYAN:** Yes, so I guess a lot of your time is spent on making sure that you can make payroll at the end of the month, where do we get the cash this month. You've got Treasury, the government, the shareholder, on the other side, which has got you under a microscope because I guess they are tired of having all of these bailouts go on and on and on. So you are in a difficult position, therefore, you have to spell out a road map or the business rescue practitioners have to spell out the road map before Treasury is going to release the purse strings.

**DEON FREDERICKS:** I agree, and I think it's always important that an organisation with a culture needs to understand that. We've had a session sometime with some stakeholders where we have indicated this and indicated but everybody needs to step up because government will not continue to bail us out, and many of the people didn't want to do that.

**CIARAN RYAN:** For people overseas who don't know, just give us a quick idea of the fleet of SAA and there is a restructuring of that fleet that is going on and why is that.

**DEON FREDERICKS:** We've got around about 50 wide bodies and narrow bodies. As you have cancelled a significant number of the routes you will have to reduce that fleet now. As you know, we brought in four A350s, which is significantly more fuel efficient, so at least we'll get efficiencies from that. As part of the business rescue process you can now renegotiate all the contracts on the table, which will give SAA then an ability to have a lower cost base and that's critical because you need to do both, you need to do the revenue line and you need to address the cost line urgently.

## **Staff morale low as layoffs loom on the horizon**

**CIARAN RYAN:** What is the staff morale like?

**DEON FREDERICKS:** As you can expect, suddenly if you have something like a Section 189 over your head, everybody is immediately focused on me, what will happen to me, where is my block in the structure, will I have a job, so the morale is not high. As management we need to make sure that we continue speaking with them, communicate, because that's the only thing that you can do, and be as transparent as you can.

**CIARAN RYAN:** Right because it's quite clear that there are going to be layoffs and it's just in what sections of the organisation that these layoffs will be.

**DEON FREDERICKS:** Yes, it will depend on the final negotiation and consultation with the unions and based on that what the final structure and shape of the organisation will look like.

**CIARAN RYAN:** Just to wrap up here, we are running out of time but I think you did touch on this a little bit earlier, I think Lufthansa, Virgin and virtually every airline in the world is going to go through a similar process, are they not, Virgin doesn't have the option of going to the government but Lufthansa could certainly go to its government and say this is force majeure, we don't have any other option but to come to you cap in hand, please bail us out. Even looking in South Africa, your other competitor, Comair, which flies the British Airways brand, they did quite well but now their results are showing similar kinds of stresses.

**DEON FREDERICKS:** Everyone will have to look, and I think ultimately what I say is people say let's wait until this abnormal situation washes out. I think there's a different view that one needs to take in a global integrated environment, where you don't have control over a significant number of variables, that you say this abnormal situation is the new norm, this is the new normal and you need to plan around that and manage around that, and make sure that you have contingency plans if anything happens like the coronavirus what is Plan B and what is Plan C.

**CIARAN RYAN:** Final question, Deon, and it's about you, where did you grow up, where did you go to school, are you a family man, tell us a bit about yourself.

**DEON FREDERICKS:** I grew up in Kuils River in Cape Town, I went to Elsies River High School, which at that stage people saw it as a gangster school...

**CIARAN RYAN:** And was it, was it rough?

**DEON FREDERICKS:** It was a good school and I think it applies to education today and we see it in matric results as well. We need to focus on those schools as well because if you look at the products that came out of the schools, they are in top management positions currently with all the challenges around that. I articulated at that stage at Coopers & Lybrand in Cape Town. I couldn't find work in the apartheid era in Cape Town in the '80s.

**CIARAN RYAN:** So you were articulated and you couldn't find work?

**DEON FREDERICKS:** Yes, and the funny thing is I phoned for a job interview and they sounded impressed until I walked in and they realised I'm not white.

**CIARAN RYAN:** So that was it, really, hey.

**DEON FREDERICKS:** So I ended up in Bophuthatswana, in Mafikeng...

**CIARAN RYAN:** Which is now the North West province in South Africa.

**DEON FREDERICKS:** I lived in Mafikeng because I had a family at that stage and I had to look after the family, two girls and one boy. Then afterwards I wanted to come back to Cape Town and couldn't, so I started out at internal audit in Telkom, I was then requested to go and set up an audit function in Cape Town and after that I took over all the regions of internal audit and then moved across because audit was never my first love, I moved over to finance and I became responsible for the executive in the Western Cape, later I took over The Eastern Cape as well. Then the Americans arrived and centralised everything to Pretoria. So I had the option to either stay there and have better quality of life and 25% of the job I had previously or go to Pretoria and I agreed to go to Pretoria for three years, and then it was 20 years later.

**CIARAN RYAN:** Is that right, so worked your way up from internal audit to CFO?

**DEON FREDERICKS:** Yes, when the Americans left I became what they call in the US the controller for the group, after that I was deputy CFO, then CFO and then retired when I was chief of investments, and then the opportunity or the request came to assist.

**CIARAN RYAN:** Right and here you are today. Okay, we are going to have to leave it there. Deon, thanks so much for coming into the studio to talk to us. Please come back again in a few months' time for an update on what has been going on at SAA and I hope you can accommodate us.

**DEON FREDERICKS:** Thanks very much for the opportunity.

**CIARAN RYAN:** This is the opportunity to invite you to



Obtain the Certified Financial Officer designation, which is offered by the South African Institute of Business Accountants. This is really the Formula One of accounting designations and is available only from the South African Institute of Business Accountants. The CFO designation is internationally recognised and validates the years of toil and ingenuity that it takes to reach the top of your field. You'll be part of an exclusive and powerful network of CFOs and finance executives. As a CFO, which is a Certified Financial Officer of South Africa, you get to share in a wide range of benefits, you gain status as an international finance executive and achieve your listing in the official CFO directory. You'll receive exclusive invitations to the CFO Talks events and get a chance to connect with knowledgeable thought leaders within the CFO community.

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## Choice of performance standards-relative or absolute?

*by Yuhchang Hwang and Yi Lu, China Europe  
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### ABSTRACT

It is important to design a performance evaluation system that truly reflects the overall performance of firms and their employees' efforts objectively and effectively. From the perspective of "accuracy of performance standards", this paper addresses the issues

in the choice of performance standards and its practical implications. By analyzing cases of various designs of Relative Performance Evaluation (RPE) for executives

and different employees and the defects of force-ranking appraisal systems in both China and North America, we hope to offer some practical guidelines on the design and choice of an RPE. The ultimate goal of this exercise is to provide an effective and practical framework for the design of RPE that is a fair, transparent and consistent with a firm's business strategy for proper motivation.

### KEYWORDS

Performance standard; Relative performance evaluation; Benchmarking

### Perspectives

#### Three Aspects on the Choice of Performance Standards

There are three key elements that are critical to the success in the design of an effective appraisal and incentive system:

- (1) Choice of performance metrics – i.e., selection of the "right" metrics.
- (2) Choice of performance horizon – i.e., the corresponding performance period.
- (3) Who are the peers to compare against – i.e., what to compare against?

'Choice of performance metrics' refers to the selection of proper benchmark metrics for evaluation. For example, should we use return on equity (ROE) or return on assets (ROA) to evaluate the management's effectiveness of the use of capital? Should we use qualitative or quantitative indicators, financial or non-financial measures? These are issues related to the choice of effective performance metrics.

'Choice of performance horizon' refers to the selection of measurement period and the proper weights on the selected metrics. As an example, what should be the length of performance period to be used to evaluate manager's outputs? Should we use rolling indicators or simply rely upon current period's outcomes? How are the different weights applied for a set of selected metrics for performance? What weights should be the qualitative and quantitative indicators?

'Who are the peers to compare against' refers to the proper selection of a set of peer group firms or performance targets (such as budget) for performance benchmarking. A firm can select to compare its performance with a preset target such as profit growth or sales growth target. This is what we call as the 'absolute performance targets.' Alternatively, a firm can compare its performance against the weight



average of the performance of a set of peer group firms' performance or against the market index. The latter is called the 'Relative Performance Evaluation' (RPE).

Theoretically, the objective of a proper choice/design of these three elements in a performance appraisal system is to ensure the overall accuracy of evaluation system such that it could properly reflect the 'true' abilities or efforts of the management team. (Banker and Datar,1989; Bushman and Indjejikian,1993; Xu Dingbo and E Lili,2018)

### **On the Informativeness of the Performance Metrics**

The fundamental principle of incentive (agency theory) tells us: in order to make the incentive more effective, more informative metric should be required, which will result in lower noise measure. From the practical perspective, the informativeness principal is measured by whether the selected metrics can truly reflect the true efforts and inputs of a manager. Due to the asymmetric information, the real inputs and efforts of a manager are unobservable, whereas performance outcomes are much easier to evaluate; and these metrics can be specified in manager's performance contract. Generally, the degree of accuracy of the measures is affected by the following factors:

#### *What to measure*

By the nature of the measures, performance indicators can either be grouped as quantitative or qualitative indicators. Quantitative indicators refer to metrics that can be measured relatively in an objective manner. Quantitative metrics are measures such as net profits, profit growth, target sales, sales growth, unit cost, market share and other hard indicators. These are measures with relatively higher degree of precision. Quantitative measures can either be financial indicators or non-financial indicators: Financial measures include accounting and market measures, whereas non-financial measures often consist of metrics such as sustain- ability, product quality, customer satisfaction and more importantly measures on corporate strategy implementations. Qualitative indicators, on the other hand, refer to the measures that are hard to quantify and with greater subjectivity in its nature. Measures such as an employee's working attitude, leadership, corporate value, professional ability and ethics, etc.

Qualitative measures are subjective and can easily be affected by the evaluator's preference, sentiment,

Prejudice, even by political manipulation, so these metrics inherently has much greater noise. From the perspective of measuring a manager 's efforts, performance metrics can be grouped as input, process/procedures or outcome measures. Input measures refer to measures on an employee's specific skills, ability, professional certification, or training received. It includes specific diploma/degree/ certificate required for the job, such as training on six-sigma quality control, specific regulatory and compliance knowledge for risk management, internal control, auditing, etc . All these measures are by its nature grouped as input measures. The objective of process measures is to evaluate whether a particular employee performs in compliance with particular procedures or regulatory requirements . Process measures are of particular importance when the specific tasks performed are 'guardian' type positions, i.e., risk management, internal control or treasure, safety and quality assurance. Operators of critical core IT infrastructure, public safety facilities, risk management and compliance office... etc., are in congruence with such measures. As outcomes of such tasks often relate to the overall risk of the enterprise, consequently they must strictly follow the pre- set management standard and procedures.

#### *How to measure*

How to measure the 'performance' refers to issues related to the choice of the performance horizon and the selection of proper weights for the measures. For example, should the performance period be one year, three-year or a multi-year rolling measurement for the equity awards? What is the proper weight for operation versus strategic metrics? How should the weights between quantitative and qualitative measures vary across different management responsibilities, position and tasks performed? These are important but practical issues in the design of a performance evaluation system.

#### *Who are the peers to compare against*

All performance standards are set with a particular business target or 'benchmark goal' in mind. In general, the 'benchmark goal' can either be an absolute or a relative performance standard. An absolute performance standard is set and approved by management team or the board with a predetermined operation budget target such as targeted sales, EPS, Sales Growth, ROE ... etc. A manager's performance is then determined by comparing the actual operation outcomes against the preset target numbers. Thus, the performance of a manager under an absolute performance appraisal

System is determined solely by its own operating outcomes, not by relative ranking comparing against its peers (i.e., other individuals in the groups or peer companies).

Contrary to an absolute performance evaluation system, a Relative Performance Evaluation (RPE) system compares an individual's performance outcomes against her peers in the organization. This type of system widely adopted by companies is called as a 'forced ranking system'. Under such a system, an individual employee is evaluated and rated again her peers based upon the predetermined performance metrics. Individuals are then classified according to their performance ranking (e.g., outstanding 10%, top performance 30%...). The relative performance evaluation system when applied within the organization, often results in 'ranked-and-fired' of the 'incapable' or 'incompetent' performer. When applied at the firm level, RPE requires that the overall company performance must be compared against its peers in the industry or a set of market index.

The main objective of an RPE system is to mitigate or remove the effects of external economic fluctuations, regulatory changes

### Perspectives

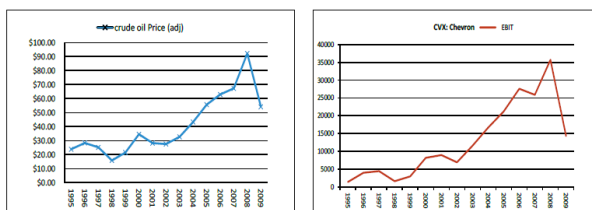


Figure 1: Crude oil price (adjusted for inflation) versus CVX EBIT

or 'noises' which is out of the control of the management team from the selected performance measures. Hence, the ultimate goal of an RPE is to improve the 'precision' of the selected performance measures and eventually improves the overall effectiveness of the evaluation process (Gibbons and Murphy, 1990; Zhang Xihui, Shi Linna and Wang Ping, 2017).

In sum, as implied by the informativeness principal of the agency theory, the more precise the measures, the greater incentive for the manager and more effective the performance evaluation system will be. (Banker and Datar, 1989; Bushman and Indjejikian, 1993; Xu Dingbo and E Lili, 2018). Certainly, choice of performance standard must be led by a firm's strategic vision, hence strategic 'relevancy' on the choice of metrics is critical to the system design.

Nevertheless, relevancy may not necessarily lead to greater 'precision' of the metrics and similarly, measures with high 'precision' are not necessarily highly relevant.

Regarding the 'precision' of a performance metric, consider the following example: In 2005, EXXON MOBIL announced record earnings of USD 36.13 billion. That was the highest annual profit any American company has ever earned. Share holders of energy companies surely and greatly appreciated the gains that sky-high oil prices had brought. But the return they have received paled next to the bonanzas received by the executives running these companies, proving again how imperfect the current state of pay-for-performance can be.

Did the sharp rise in corporate profit of oil companies occur mainly by luck or because of the true abilities and efforts of the executives? Consider the following chart of another oil company's earnings during that same period. Comparing Chevron's earnings before interest and tax (EBIT) and the crude oil prices (see Figure 1), which look almost identical, suggests that oil companies' profits are largely affected by price fluctuations of crude oil.

Figure 2 provides another example that highlights the relationship between the volatility of oil prices and the performance of the oil industry as a whole from 1977 to 1994: (a) represents the fluctuation of the oil price per barrel after adjusting for inflation, and (b) represents the change of the oil industry's aggregate accounting earnings index. Clearly, upon the formation of OPEC after the first oil crisis in 1980s, movements of the oil price and the accounting earnings of the oil industry were almost identical.

According to the incentive theory, the necessary condition of a strong incentive scheme is to ensure high 'precision' of the measures or metrics. A high precision of a metric implies that the performance indicator must be able to reflect the underlying manager's true abilities or efforts level. An effective performance evaluation system and the corresponding compensation scheme should be able to filter out the 'noise' from the market; i.e., to eliminate the luck from the measurement system. When correlation between accounting profit changes of the oil company and the crude oil price fluctuations reaches 80% level, there is definitely an element of 'luck' in using any profit-based KPI for its executives' performance evaluation. When earnings was used as measure for KPI and it was highly correlated with uncontrollable external economic factors, we are essentially injecting a big proportion of

'luck' elements into the performance appraisal system. This completely violates the 'Informativeness Principle' in the design of an incentive and performance appraisal system.

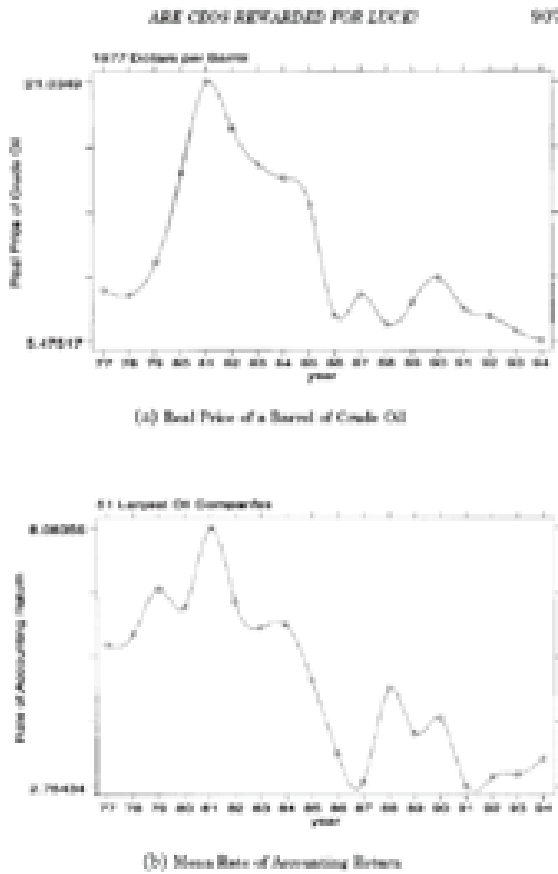


Figure 2: Fluctuation of oil prices and the performance of the oil industry

Source: Bertrand M. and Mullainathan S., Are CEOs Rewarded for Luck? The Ones without Principals Are, *The Quarterly Journal of Economics*, 2001, 116(3): 901-932.

A similar situation has occurred during the same period of time in Taiwan's steel industry. In 2005, the CEO of China Steel Corporation, a stated owned enterprise in Taiwan, received a record-high cash bonus at market value equivalent to RMB 10 million. When questioned by the Legislation Yuan, Taiwan's legislative body, the CEO's comment was indeed simple. He claimed all he has received was legal as the Board set a profit-sharing award to the management team. Hence, more earnings imply more bonuses for all the management team. On the surface, such an argument that more profits imply greater awards for the management team sounds reasonable and logical. However, the fundamental issue is about whether 'profit' figures of a steel company can truly reflect the management's abilities or efforts, i.e., the relevancy and 'precision' aspects of the selected performance measures. Consider yet

Another simple data analysis on the relationships between iron ore price and the market price index of the 'cold rolled steel'. Figure 3 presents our findings: The iron ore price index and the cold-rolled steel product price index from the Federal Reserve database (June 1982 to June 2017). Clearly, correlation between iron ore price and the steel cold roll price index is extremely high, close to 83.6%, which indicates that there is a very high correlation between the profits of the steel industry and the price of iron ore.

To sum up, informativeness principal requires that choice of performance measures must reflect the 'true' efforts or abilities of the manager for effective evaluation and incentive. To address the 'precision' and informativeness of selected measures for performance, we must thus contemplate the following important issues in the system design.

In industries such as steel, oil and natural gas, corporate profits are affected greatly by the fluctuations of raw material prices. In such circumstances, would accounting profits, sales or growth related metrics be the effective measures for manager's performance?

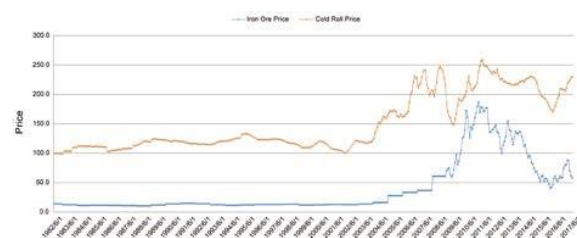
(2) In highly regulated industries, firms' profits could be impacted greatly by the sudden government regulatory changes; again, for such industries in China, should we simply use accounting profitability, sales or growth budget/target as the key metrics to evaluate the performance of their executives?

(3) For which industries is it critical to exclude the influence of luck factors when we consider the design of a performance appraisal system?

(4) Finally, should company executives be responsible for uncontrollable factors, such as market fluctuations and political uncertainty factors?

In short, when designing incentive mechanism and performance evaluation system, an important consideration is to choose the proper measures such that the impact of luck factors in the performance evaluation could be minimized. Selection of the performance standards and the corresponding

## Perspectives



Source:  
<https://fred.stlouisfed.org/series/PIORECRUSD>



Design of performance evaluation system can roughly be divided into two main categories: the absolute measures and the relative performance evaluation. The design of absolute measures requires that the actual performance outcome of enterprise to be compared against a pre-set budget or target. An interesting practice in industry is to set the performance target higher than the target value of the previous year or quarter. The design of a relative performance evaluation system (RPE) requires that the performance management of a manager is to be compared with that of her peers and competitors in similar BU/products/ regions. The final outcomes of the appraisal are thus contingent upon the comparison to the peers or ranking in the group.

### Problems with an Absolute Performance Evaluation System: uniform Rating

An absolute performance evaluation system asks a manager to rate the performance of the subordinates based upon preset performance targets. The corresponding metrics used could either be qualitative (leadership, team spirit, customer satisfaction, etc.) or quantitative indicators (sales volume, department net profit, production cost, etc.). Inevitably some subjective measures could be used in the rating, and some self-interested managers often have little incentive to invest in performance evaluation.

The main reason for this trend is that no one wants to be the bad guy. Managers may have to face disgruntled employees and huge personal costs may occur if poor performance rating is assigned to an employee. As a result, under the absolute performance evaluation system, we have observed the common occurrence of assigning 'uniform rating' by the manager. This is very much consistent with the so-called Lake Wobegon Effect — 'where all the women are strong, all the men are good-looking, and all the children are above average.' With more qualitative measures or too many performance metrics used (for mid-level position, no more than 15 measures in total), the phenomenon of 'uniform rating' is more likely to occur. The 'uniform' performance appraisals render the whole evaluation process ineffective, and result in producing poor incentive for the employees. Thus, unable to effectively weed out the incapable employees eventually results in the departure of the capable performers; this is the so-called 'Bad money drives out the good.' undiscerning performance appraisals system frustrates the competent employees, who often have better career opportunities and will pursue other employers.

This eventually causes an organization's 'brain drain' and leads to the decline of organizational ability. Consider the case from Merck. In the 1990s, Merck paid more than the market-average to attract the best and most talented employees, with a base salary that was set at 80 percentile in the industry. Merck used the absolute performance rating by grading its employees on a scale from 1 to 5, with the lowest scale as 1 and the highest score as 5. Distribution on the actual appraisal ratings of a particular year was shown in Figure 4 (there were about 7,000 employees in North America): Results in about 60% of the employees were rated at fourth grade, 37% in the third grade, 0.12% in the first grade, and 1.32% in the fifth grade. In other words, more than 90% of employees received an appraisal score in the range of four or three points — which effectively confirms the phenomenon of 'uniform rating.'

Imagine the consequences of such an appraisal system on individual employees. The fact that less than 1% of the employees have received a 5 in the ratings is likely to frustrate and demotivate greatly the ones who have received a rating of 4+ or 4 score. While this group of individuals are the true performers of the organization, in the meantime they are likely to have more opportunities and potential to find better jobs. These are the individuals most likely to leave the organization, in particular when their basic pay raise and growth of the organization slow down.

Meanwhile the number of the employees received 1-2 point rating is basically ignorable. More importantly, these are the individuals who are not competitive enough to change jobs and will likely continue stay put. This is exactly the 'bad money drives out the good' phenomenon which results in outstanding employees not being recognized and inefficient employees not being eliminated. Year after year, the productivity and quality of employees and the overall strength of the enterprise will decline. received 1-2 point rating is basically ignorable. More importantly, these are the individuals who are not competitive enough to change jobs and will likely continue stay put. This is exactly the 'bad money drives out the good' phenomenon which results in outstanding

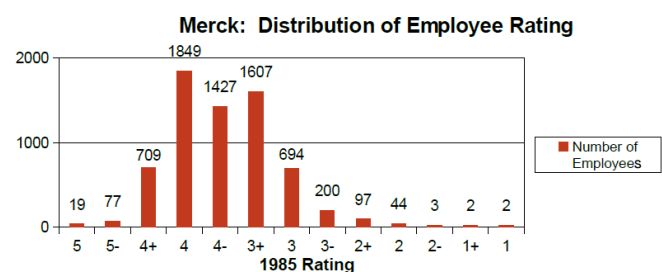


Figure 4: Merck's performance appraisal and salary administration program (PASA)  
Source: Murphy, K.J. Merck & Co., Inc.(A) & (B), Harvard Business Case ( 9-491-005 & 006), 1990: 1-6.

Employees not being recognized and inefficient employees not being eliminated. Year after year, the productivity and quality of employees and the overall strength of the enterprise will decline.

To avoid the above problems, we suggest the following when designing an appraisal system of an absolute performance measurement: Effective objective metrics and clearly defined rules and procedures of appraisal are the key. The main set of KPIs must be objective ‘hard’ measures as this could significantly remove the room for managers’ manipulation. ‘Quantify’ all soft measures (qualitative) by providing detailed definition of the measures and to ensure the true objectivity of the rating process. Finally, ensure the transparency of the appraisal process and thus minimize the personal cost of the supervisors.

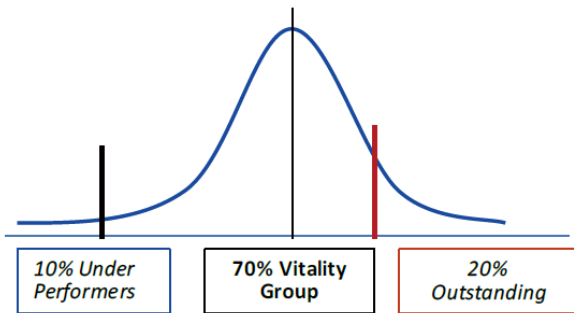


Figure 5: GE's vitality curve

### Relative Performance Evaluation (RPE) and Forced Rating/Ranking

In order to cope with the ineffective attrition of underperform employees caused by the uniform rating of an absolute evaluation, firms have over the past decade adopted relative performance evaluation (RPE) systems or have more aggressively used the forced ranking and the ‘ranked-and-fired’ for attrition.

Forced rating/ranking requires department supervisors to group employees' performance into several levels based on predetermined performance indicators (performance categories usually designed as 3 to 5 levels). The proportion of employees at different performance levels is set in advance. When an employee is rated at the lowest level of performance, he/she is often put on probation. Employees who fail to significantly improve their performance within a certain period of time (say six months) will be dismissed. Therefore forced rating/ranking is called Ranked-and-Fired system. The best-known example is GE's ‘vitality curve’ (see Figure 5).

GE's forced rating/ranking system requires managers to identify the bottom 10% of employees. As expected, managers often have included the weak, departing or even dead employees into the bottom 10%.

Many well-known companies in China have implemented the RPE system for years. As an example, Haier Group puts its employees into three categories based on their performance: Excellent, Qualified and Probationary. Employees' work performance will be evaluated on a regular basis, and individuals who failed to meet the performance standards will be included in the Probationary group. These individuals are then encouraged to re-enter into Haier's internal labor market for additional training and later compete for the new internally available positions. In 2009, six senior vice presidents of Haier group were fired for not meeting their performance targets set at the beginning of the year. In addition, Huawei's ranked-and-fired system is another model of using relative performance evaluation (RPE). Of course, there are also many unsuccessful applications among well-known firms. Under the reign of Steve Ballmer, Microsoft developed a ‘Stack Ranking’ system for its performance management. It requires that each business unit must rank employees into different performance groups. The performance management system, in which employees beat their peers to get promotions, bonuses or keep their jobs, reduced Microsoft's ability to innovate and grow, and even to the extent of being a contributor to its ‘lost decade.’ Our empirical study found that more than 35% of enterprises in the United States use relative performance (see Table 1).

Panel B. Use of RPE and length of performance period

	N	Use of RPE	
		Yes	No
2006-08	435	162 (37.2%)	273 (62.8%)
2009-13	1007	422 (41.9%)	585 (58.1%)
2006-13	1442	584 (40.5%)	858 (59.5%)

Source: Contractual features of CEO performance-vested equity compensation, by Zhan Gao, Yuhchang Hwang, Wan-Ting Wu. *Journal of Contemporary Accounting & Economics*, 2017(13): 282–303.

### Potential Problems with Forced Rating/Ranking

Let's take a look at the potential problems of the forced rating/ranking system and the reason.

### 1. Potential negative perception on RPE by the employees – on fairness & employees' psychological impact

A survey of employee satisfaction conducted by the Hay Group found that employees with better performance in a company get more frustrated because they believe they are easily overlooked. The survey of 335 employees found that 32 percent of them believe that companies tolerate the underperformers mainly because the performance evaluation system was not designed properly and implementation was just a mere formality.

Let's try to see how employees feel when rated in different ratings under a forced rating/ ranking system: Employees receiving an A rating are truly the outstanding performers in the organization. Nevertheless, under this RPE system, supervisors across departments may still have to battle with each other for the precious awards slots for their own group. The process of office politics could create much resentment and frustrations among the recipients with top rating, for whom an A rating may actually feel like a B. This explains why a large number of outstanding employees choose to quit a relative performance evaluation system is used in the company. Similarly, people who got a B rating are more likely to worry about getting a C next time. Generally speaking, the employees rated as

Table 2: Some practices of forced ranking in the U.S.

	Rating	% distribution	Litigation	Outcome
<b>Ford</b>	Adopted the RPE Rating System in 1999	A=top 10% B=middle 80% C=bottom10%	In 3/14/ 2002, Ford settled two class-action lawsuits for \$10.5 M	4/29/2001 Abandoned the system
<b>Goodyear</b>		A=top 10% B=middle 80% C=bottom10%		2002 Abandoned the rating system
<b>GE</b>	Adopted RPE in the 1980s	A= top 20% B= middle 70% C= bottom 10%		

Source: Osborne, T and McCann, L.A. Forced Ranking and Age-Related Employment Discrimination, *Human Rights*, 2004, 31 (2): 6-10.

'B' often account for more than half of the total number of employees, which implies that most employees within a firm are just able to meet the standard or simply mediocre in their performance. Therefore, it is a top priority for firms with an RPE system to constantly motivate, inspire and encourage its employees in keep up their morale and build a sense of belonging. Finally, employees who receive a C rating tend to think that the evaluation is unfair and that their contribution and ability should be much better reflected in the rating system. Discrimination is another issue. Forced rating/ranking tends to result in racial, gender or age discrimination. According to studies, in the United States, under the forced ranking system, a fixed percentage of workers are eliminated each year, of whom many are older workers or women.

Implementing a forced rating/ranking system without careful planning or design often makes the vulnerable groups victims of the system. There are already a number of firms in the US, such as Ford and Goodyear (see Table 2), that have been sued by their employees for using forced rating/ranking; and in many cases, the practice had to be abandoned. Firms must carefully design and address all the concerns when implementing the RPE evaluation system.

### 2. Adverse impact on organizational learning and innovation – leading to increased internal competition and less communication or innovation

Organizations that promotes information sharing and encourage free communication of specific knowledge could significantly minimize the asymmetry of information and build trust among its members, consequently reducing many of the moral hazard problems within the organization. Nevertheless, in real situations, due to their need for self-protection, people often hide their valuable private information, experiences or particular skills/knowledge from others, even though such information could have great value to the organization.

Employees are genuinely concerned that their personal value to the organization may diminish significantly once their valuable private information is shared and converted into some management procedures/protocol. Therefore, internal competition will intensify and the desire to share knowledge will diminish when an individual's bonus is tied closely to performance, which is again based on ranking. When employees have to compete with each other and firm's decision on attrition is mainly based on a bottom ranking, fears can run high in the organization.

Such an environment is never conducive to collaborations. It will force people to act selfishly and destroy the virtuous circle of information sharing and mutual learning. It is an unhealthy competitive environment that is not good for the synergy of the team. At a time when horizontal organization is the order of the day, organization form today is more project-based, in teams oriented by knowledge and ability and work tasks are more flexible and independent. For employees, it is no longer 'what the boss requires me to do', but 'what I can do with my ability and experience'. At this time, close cooperation, information exchange and continuous learning across teams and departments are required, which cannot be properly evaluated using relative performance evaluation. Therefore, once a company decides to use relative performance evaluation or forced



Rating/ranking, the appropriate tasks should be more personalized individual operations, less teamwork,

and not requiring a lot of mutual learning and information exchange among employees. On the contrary, if the task requires a lot of cross-departmental cooperation and learning, then the implementation of relative performance evaluation or forced rating/ ranking obviously does more harm than good. In order to encourage communication, the incentive design should include the following: (1) individual incentives combined with team incentives; (2) non-short-term, non-immediate incentive payments; (3) guaranteed long-term welfare for the employees (incentives similar to that for 'infantry' positions can be considered).

### *3.The influence of political games- the negative influence of distorted behavior and organizational climate*

In companies that implement forced rating/ ranking, managers try their best to complete their target for bottom ranking attrition without offending their staff, and would often make the following arrangements:

- (1) For employees who need to be dismissed due to poor performance, they will not be dismissed immediately in the middle of the year and will be put into the category for attrition when employee performance is ranked at the end of the year. If the attrition quota is already filled, they will be retained for one more year before the next ranking takes place.
- (2) Employees who take voluntary separation or retirement or pass away unexpectedly during the year are all included into the quota for attrition.
- (3) The least senior employees are often the first to be put on the attrition list.
- (4) Employees who are unassigned and are temporary staff in a team as a result of organizational structure changes will most likely be put on the list for attrition.
- (5) In order to meet the quota, performance record may be faked.
- (6) Employees are asked to take turns in receiving the best evaluation, which means that this year you are the best and next year it will be someone else's turn.

These distorted behaviors are likely to help retain employees who should actually be let go and bring negative impact on the organizational climate and fairness. For the purpose of mechanism design, in addition to quantifiable objective performance indicators and supervisor evaluation scores, it is suggested that third-party verification and an employee appeal mechanism should be added.

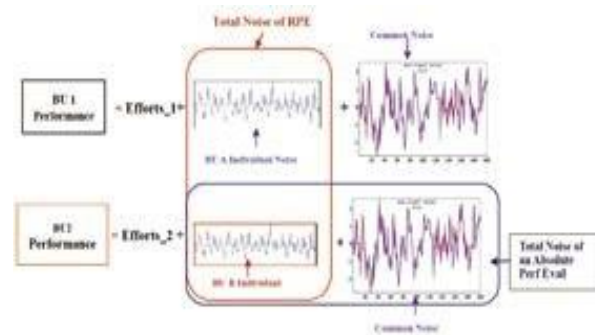


Figure 6: Relative versus absolute performance evaluation

Human resources department/HR business partners should have the right and responsibility to review the authenticity of such rankings to prevent possible manipulations by supervisors in rankings. Ranking could indeed be a useful basis for making decisions on incentives, attrition or promotion, but we should not do it just for the sake of doing it. It should return to its original intention to truly reflect the essence of business, and motivate and guide employees more effectively.

### **Why Relative Performance Evaluation?**

In a nutshell, a company chooses to use relative performance evaluation or forced rating/ranking to exclude the effect of external uncertainties, especially luck, on performance evaluation through a relative comparison between employees.

### **When to use Relative Performance Evaluation?**

As one previous example indicates, when the tasks performed among the employees are similar, there are still certain unique noise and uncertainties associated with each individual agent. In economic theory, we call such noise as 'individual uncertainties,' or 'idiosyncratic' noise, such as the differences in manual operations, physical conditions, procedures and processes, supervisor's management style, appraisal process by different departments, and interpretation of the performance metrics. When sales people cover roughly the same geographic region with similar products, then the difference in performance across sales agents is nothing more than individual ability, efforts, plus the individual noise faced by each individual. Conversely, when we compare the performance of the agents from different geographic regions in China: north-west versus south-east coastal regions, we expect many factors can impact performance. We expect the influence of the regional factors in this circumstance (i.e., individual noise) will be greater.

On the other hands, there are external economic or industrial uncertainties that could impact all agents across the industry, in all firms, such as changes in oil and gas prices, government subsidies on new energy initiatives, fluctuations in interest rates caused by central bank policy, etc. These types of unexpected events or uncertainty are called 'common uncertainty' or 'external noise.'

The quality of a company's performance evaluation system determines the noise level of 'individual uncertainties' in an evaluation system. In general, 'individual uncertainty' can be managed or mitigated via proper system design. In a properly designed evaluation process, we can lessen the impact of various 'individual noises & uncertainties'. Consequently the majority of the remaining noise in the measurement system can be attributed to external uncertainty factors. In such circumstances, the RPE could effectively filter out the external noises and eliminate the external environment uncertainty. A precondition for having a highly effective RPE is to control the 'individual noises' in the system. Lack of clear definitions on performance indicators, inconsistent measurements, high proportion of qualitative metrics, changing measures abruptly, etc. could only increase the noise of 'individual uncertainty' and is not conducive for applying an RPE. It is important to note that under relative performance evaluation, we also bring the noise of other people's uncertainty into the measurement system. From Figure 6, we can clearly see that the main purpose of relative performance evaluation is to filter out external noise. Therefore, when the external common uncertainty far exceeds the internal individual uncertainty, relative performance evaluation will be more effective. When the external noise is bigger and the influence of external uncertainties on performance becomes the dominant factor, RPE will be more effective for performance evaluation. From the purpose of system design, in a relative performance evaluation, all efforts should focus on minimizing the impact of 'internal uncertainties and noises'. After all, firms may not be able to control external environmental uncertainties, but they can surely manage their appraisal system in a way that will minimize the 'internal noises' and thus improve the overall efficacy of an RPE.

Let's look at the design of Baosteel's 2014 equity incentive plan as shown in the Appendix. The performance indicators used in Baosteel's equity awards consist of both absolute and relative ones.

The third one for the value of EVA and profitability figures is an absolute indicator mandated by SASAC.

The most challenging metrics for this award are first two measures set up by the Board: net income (profitability) of Baosteel must be 2.5 ~3.0 times (increasing each year) bigger than the average of the eight top domestic steel producers in China; and at the same time, Baosteel's net profit per ton must rank top 3 among the six largest global steel competitors, which is fully in line with Baosteel's strategic goal of becoming the most competitive steel company in the world. The market performance of Baosteel shares shows that the equity award incentive turned out to be very effective. It is worth mentioning that Baosteel uses the per tonnage net profit as the core metric for ranking against her global peers, which effectively removed the influence of iron ore price fluctuations on profitability.

### Issues in the Design of a Relative Performance Evaluation System

As we design an RPE, we must make sure that we have a comprehensive and effective system by identifying the important factors to be included in the system, such as the products, operational processes, competition strategies and the corresponding labor market.

#### Key Point Number 1:

Minimizing the internal noise of the system

The most critical consideration in the design of an RPE is to minimize the unnecessary individual noises and uncertainties in the evaluation system. Here are a few important points that can help with the design of an effective appraisal system:

Ensure homogeneity among the participants: as discussed before, the basis for an effective RPE is to minimize the internal noises. Greater homogeneity among the participants reduces the variations and noises across individuals. It makes the process of peer comparison more effective and allows the relative ranking to filter out the impacts of external or common uncertainties on the performance outcomes. At the very beginning of the design process, we need to consider whether the subjects to be evaluated (different employees in the same department or across different departments) are from similar departments, perform similar tasks, or in the same market. A forced rating/ranking system will not work when subjects fail to meet the criteria of homogeneity, i.e. if they have extremely diverse product portfolios, across different geographic regions, with different job responsibilities and tasks.

The size of the pool matters: the number of participants in the pool for ranking should be no fewer than 30. From the statistical point of view, too small a sample size can lead to greater noise. More importantly, a small pool for ranking encourages collusive behavior among employees. In a department with only a few employees, the manager may find it difficult to implement the forced ranking, as it will unnecessarily eliminate those who are not supposed to leave (staff at with bottom ranking in department A may even be stronger than the average level in department B).

Maintain clarity and transparency in measurement: First of all, the definition, calculation method and interpretation of performance indicators must be clearly articulated, and there must be objective, rigorous and clear standards to evaluate the staff. It is important not to leave ambiguous areas or space to maneuver, and to make sure there is nothing that will make employees suspicious of 'dark box operation'. Secondly, it is necessary to avoid using qualitative or soft indicators; for metrics with a weight of more than 20%, they must be used with hard indicators (harder indicators must be applied for stronger incentives, and appraisees at senior levels of management). If it is unavoidable, qualitative indicators should be quantified as much as possible. For example, customer satisfaction can be measured by the number of complaint calls. At the same time, it is advisable not to use too many subjective evaluation criteria, such as setting a simple requirement to 'refer to the score of the immediate supervisor'. In the case where a rating by the superior is needed, specific rating criteria must be provided for guidance and reference.

Maintain the professionalism of measurement personnel: In addition to having a complete understanding of the measurement process and criteria, measurement personnel should receive professional training as how to observe, analyze, record and score in order to obtain adequate and comprehensive information. Assessment committees for different topics or areas can also provide their own rating for different categories under review, so as to reduce the bias and noise in the scores that the supervisors may have subjectively given.

#### Key Point Number 2: Fewer Grades for Rating

If a company chooses to use relative performance evaluation, especially forced rating/ ranking, we suggest that no more than 3 to 5 grades should be used for performance ranking.

Table 3: Choice of grades for RPE: seven versus three

A	Outstanding	A	Outstanding ✓
B	Excellent		
C	Exceeding expectations		
D	Meeting expectations	B	Meeting expectations
E	Satisfactory	C	Needing Improvement
F	Needs improvement		
G	Below Target		

Too many grades for an RPE makes it difficult to precisely define the corresponding performance rating standards. For the purpose of system design, clearly defined performance metrics and the corresponding rating guidelines are prerequisites for an effective RPE, which could help to reduce the influence of personal preferences and subjectivity of manager's rating process, and thus improve the overall transparency and effectiveness of the appraisal system. Hence, it is desirable to have fewer grades for the rating.

Too many grades may cause controversy in the rating. For managers who conduct the assessment, more detailed grades present more challenges in defining and discerning performance between the grades, especially when qualitative measures are used in the rating. At the same time, more grades in the rating system may lead to dissatisfaction on the part of the employees. With seven performance grades as shown in Table 3, there will be six groups of employees who are not be happy with the results as everyone believes that they deserve a better grade (employees graded in categories B-G account for 90% of the population). When only three different performance grades are used, there will be only two groups of disgruntle employees (employees graded in categories B and C probably account for 70%). In sum, the more detailed the performance grades are in an RPE, the greater the personal cost would be for managers in administrating the appraisal process.

Suggestions for more effective use of the grades: In the official grading, three grades can be applied, but when meeting with the employees on feedback, more levels could be used to share the rating information with the employee. For instance, within the B category, there could also be a B+ or B-, which can be used as the basis for verbal commendation or warning.

**Key Point Number 3:****Fairness, Transparency and Consistency  
of the Assessment Process**

When implementing the relative performance evaluation system, there will inevitably be some subjectivity involved in the rating process. It is crucial that the whole appraisal process is fair and transparent from employees' perspective.

**Fairness and Equity:** Equity is of particular importance in the design of a relative performance evaluation (RPE) when an employee's performance was compared against her peers in the organization. Unfortunately, the notion of 'equity' by itself is quite an elusive and subjective notion. Equity is a perception matter; it is the 'procedure equity' that ultimately ensures the feel of 'perceived equity' (rather than an objective matter) and this is the key to ensuring an equitable and fair design of a RPE. Conditions that are not conducive for 'procedure equity' are: the use of subjective performance indicators, and an opaque and

manipulative evaluation process. To ensure high 'procedure equity' of the evaluation process, we must pay specific attention to following factors: Are we using effective and objective performance measures for the RPE evaluation? Are the selected performance standards and the corresponding evaluation process properly defined and fully explained and communicated to all participants? Have the chosen performance metrics been consistently applied and are they subject to abruptly changes by the management?

**Consistency:** Performance standards must be consistently applied and cannot be changed at will, otherwise it injects more uncertainties into the appraisal system and consequently hampers the perceived equity among the participants. In the case when the firm is facing major changes in its operating environments, or technology, the management team should make efforts to communicate and clearly explain the logic and rationale for the needed changes on the performance metrics.

**Transparency:** In the beginning of each performance evaluation cycle, it is critical to have full communication on the selection of the performance standards, its linkage to company's strategy, measurement and procedures. Transparency of the whole evaluation process is the key for a successful, RPE implementation. **Suggestions for effective implementation:** In principle, each step of the assessment process should be fair and transparent and everyone should have access to their own and

Other colleagues' scores. In practice, supervisors often reserve some rights to adjust the final rating, although employees are rated based upon objective measures and metrics. Such adjustments are often used to balance the incompleteness of the existing appraisal process and to address sometimes unique circumstances faced by a specific employee or to compensate for the special contributions of individuals. For example, adjustment can occur for individuals who have made efforts or taken initiatives that may not be reflected in their short term performance evaluation but could have profound impact to the company's strategic moves or long-term performances. Such adjustment process that combines the 'hard measures + soft adjustment' by the supervisors is actually needed in practice. Hence, for some competitive positions (e.g. sales), performance scores and rankings can be published regularly to promote healthy competition among peers, but year-end adjustments for annual bonuses could be kept confidential and communicated only to the individual concerned. The annual bonus recognizes the individual's contributions in different areas, not just output. The manager, however, can disclose the final 'correlation coefficients' between the bonus and scores to ensure the transparency and equity of the appraisal process.

**Key Point Number 4:****Necessary Support Mechanisms for RPE**

Effective communication is the key. As mentioned above, keeping transparency is critical to effective implementation of forced rating/ranking. Firms should fully communicate with employees about the 'rules of the game', including evaluation standards and detailed assessment procedures. They should also keep close communication with employees throughout the implementation stage of the appraisal by letting each individual know how they have been rated and what they have been rated on. More importantly, individual should be provided with constructive advice, with information about their specific weakness, and suggestions or training for improvement. A clear and transparent appeal process regarding the evaluation should also be available to the employees to promote a fair and just organization culture. **360° Assessment:** In order to enhance the equity and credibility of the system, many companies have added 360° assessment in conjunction with an RPE evaluation. In this way, the evaluation of an employee is not determined solely by the immediate supervisor alone. All other employees who have worked with or interacted with him/her, including his/ her subordinates, peers and even customers and suppliers, can evaluate the employee's performance. Doing so would promote the equity of the



System to a great extent. However, Such a comprehensive assessment often needs to be carried out by means of an online system which involve a wide range of personnel and a high operating cost, and therefore should be implemented according to the company's own situation. It is also important that managers gather sufficient 'objective evidence' to support and promote their outstanding subordinates at group meetings where quota for forced rating is decided and looted to the department. For example, when Intel administrated its RPE, a 360 ° assessment process was implemented simultaneously. To a certain extent this could ensure a fair process and protocol for effective RPE.

**Focus of the Management in RPE:** As discussed above, the focus of the management under an RPE should be on employees who have received middle grade rating and each individual in such group of rating should know precisely how and where they have been rated. Through a complete review process, specific advice and suggestions for improvement should be given to each individual employee.

**Consultation and Communication:** In performance review and communication, managers should not only tell employees what they have done well, but also give timely and specific constructive suggestions on areas for improvement. Any performance communications with only the evaluation results without clear and targeted suggestions are meaningless. In the process of managing performance, the manager should discuss the issues with his subordinates, inspire and guide them with positive attitude and open questions, listen with empathy and demonstrate a genuine willingness to help the employees to sort out the issues and find ways to improvement with specific action plans.

#### **Key Point Number 5:**

**Avoid Things that Hurt Innovation**

Forced ranking intensifies competition among peers and thus hinders information sharing and collaboration across team members. Unless complementary measures are in place to promote group efforts and team spirit, forced ranking will definitely hurt innovative activities. RPE, in particular, tends to weed out 'dissimilar individuals', whereas sadly creativity and innovation take place for the very purpose of looking for different ideas and individuals As this point has been elaborated above in paragraphs about the potential problems of forced rating/ ranking, it will not be repeated here.

#### **Key Point Number 6:**

**'More Is Not Necessarily Always Better'**

If companies decide to implement forced rating/ranking, it is important to remember that it should done for up to three years maximum. The main purpose of forced rating/ranking is to eliminate the bottom employees with a fixed percentage. Generally speaking, it is easier to achieve the goal in the first one or two years, but it is not easy to screen out the relatively low-performing employees with a fixed percentage every year after three years' implementation. After three years, unqualified employees have all been eliminated and continued implementation beyond the third year is likely to cause excessive elimination, causing suspicion among employees. Moreover, the performance of different departments varies in different years. It is obviously unfair to re- quire the departments with good performance to eliminate the same percentage of employees as the weaker departments every year. If the purpose of forced rating/ranking is to stimulate performance, maintaining the equity of the system is the necessary prerequisite. The quota for elimination in each department should be adjusted appropriately based on its achievement.

#### **Epilogue**

As a well-known quote in management accounting says, 'You get what you measure'. A good performance appraisal system can properly reflect the real ability or efforts of the management and employees, which in effect will drive the overall performance of the firm towards its strategic goals. Effective incentive and performance evaluation mechanisms could influence and shape employees' behavior. Performance evaluation system is one of the important means of a firm's management and is also a critical enabler for its strategy. A properly designed appraisal system should always be based on the firm's business strategy and be guided by it. Selections of the measures, the choice of performance standards, and the corresponding incentive scheme should all be complementary to each other for the overall effective of the mechanism. In the end, an effective performance appraisal system needs to be in congruence with a firm's strategic goal, enabling the firm to screen, identify, and attract the right type of talents to the organization. More importantly, it should also be able to retain capable and talented employees and at the same time effectively weed out those who are not fit for the organization.



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## Appendix

### BaoSteel Equity Incentive Plan

Equity Incentive Plan of Baosteel in 2014 (unlocking conditions)

1. Annual profit must be 2.8 times of the average profit of domestic steel enterprises in the same period.
2. Per ton steel net operating profit must rank among the top three out of six global steel companies.
3. Meet the performance targets set by SASAC for Baosteel Group :
  - a. Annual revenue growth at 3% year-on-year to 186.6 billion yuan
  - b. Weighted average growth rate is no less than the growth rate of domestic publicly listed companies with A-share in the same period
  - c. EOS (EBITDA/ total revenue) is less than 10%; And no less than the 75 percentile of domestic A-share listed companies.

Domestic bench-marking peers in the iron and steel industry refer to the top 8 domestic A-share companies in the same industry in 2013 in terms of operating revenue (excluding Baosteel Shares): Hebei Iron & Steel, Taiyuan Iron and Steel Group Co., LTD , Wuhan Iron and Steel Company Limited, Ansteel, Masteel, Shandong Iron & Steel Group Company Limited, JISCO, Valin Group. Global bench-marking peers in the iron and steel industry refer to Pohang Iron and Steel Corporation (POSCO), and Nippon Steel & Sumitomo Metal Corporation (NSSMC), JFE Holdings, Inc. (known simply as "JFE" ), United States Steel Corporation (USS), ArcelorMittal, S.A. (ArcelorMittal). US" and China Steel Corporation (CSC).

## Germany CFO Interview: Gross margins beyond 80 percent are possible

Interview with **Mister Luca Mucic**, the CFO of SAP SE, Walldorf, Germany. The interview was made on March 7, 2020, and reflects the situation as of then. CFO Mister Mucic counts on strong growth in the Cloud, and does not expect, that because of the Coronavirus, the SAP will have material problems re its objectives for 2020, from Börsen-Zeitung, Frankfurt am Main, Germany, March 7, 2020, article provided by GEFIU, Association of Chief Financial Officers Germany, the German IAFEI Member Association, translator: Helmut Schnabel. The interview was made by Sebastian Schmidt



**Mr. Mucic, the spreading of the Coronavirus is presently worldwide the subject number 1. Apart from the concern about your workforce, do you already feel the effects on the business in the first quarter 2020?**

We had, like all corporations in China, extended holidays to the New Year festivities. But in the meantime all our offices there are opened again, except for the one in Wuhan. Our primary concern of course relates to our employees. They work increasingly in the home office. Also regarding business travel we are now very restrictive and limit ourselves to the utmost necessary only. Our business is by the way and in the meantime ever more composed of revenues which can be planned.

This year, these will be at around 70 per cent. This gives us, at short term crises, a certain security. Therefore I expect, that because of the Coronavirus we will not have material problems with our 2020 objectives.

**Also not in the 1st Quarter 2020?**

How a quarter is performing, we only know, when we have seen the last two to three days. Because incoming new orders are often coming in at the end of the period in a concentrated manor. Presently, regarding incoming orders, we are at a regular level for a 1st quarter. But it is still too early, to say something about it.

Is it also too early, to say something about the integration of the Cloud applications into the ERP platform. Here has been much criticism from the users.

The subject has a high priority for us already since two years. Here we have made significant progress. And here lately, with our overarching application development unit, which is headed by Mister Thomas Saueressig, we have created the structural prerequisites, for bringing together our development units. Here now are integrated also the teams of Ariba, Concur and Fieldglass.

#### **Why, at all, the integration has lasted so long ?**

Here we are not talking of a technical integration at the surface. This we already have since long. For us it is about a real integration: Experience of the users, analytics, application-lifecycle-management, and safety architecture. For Success Factors we have it already largely completed, and for the other products we have laid down in a white paper, how the time table is set up. Until the end of the year, we want to have completed almost all integration steps.

#### **You have not mentioned the latest acquisition of Qualtrics. Will there not be an integration ?**

At Qualtrics, the benefit from our point of view, is more in closely integrated application cases. Insofar has this a different character than the business processes, where, understandably, the customers expect a full integration like for instance " Hire to Retire" or "Source to Pay". We are seeing many integration possibilities for Qualtrics, but mainly in the form of analytical analyses of experience data.

#### **In this year, into the board of management compensation will be integrated the development of the Net Promoter Score, which is measuring the customer satisfaction. A favourable timing with a view to the low point ?**

When one is looking more closely at the Net Promoter Score, one sees: We have seen, with customers, who have given us a 7, or 8, an absolute growth. But the customers, who have given us a 7 or 8, are being taken out because of the nature of the system, so that the number with minus 6 % once more by one percentage point has been lower than in the previous year. We have worked intensely on finalising our integration schedule, and we count on that our customers in future will honour our stronger

Integration. In addition, you should also take note of the other evaluation criteria, for instance the Employee Engagement Index. This one, though, is not at an all time high, but in view of the restructuring program and by comparing to our industry, with 83 % at a very high level. At my compensation regulations I am looking exactly twice per year. Once, when defined, and upon final accounting. Otherwise I simply do, what I regard as best for the corporation.

#### **SAP at a Glance**

##### **Group Numbers,**

<b>Sales Mio €</b>	<b>2018</b>	<b>24708</b>
	<b>2019</b>	<b>27553</b>

<b>Operating Earnings, Mio €</b>	<b>2018</b>	<b>5703</b>
	<b>2019</b>	<b>4473</b>

<b>Operating Margin, %</b>	<b>2018</b>	<b>23,1</b>
	<b>2019</b>	<b>16,2</b>

<b>Operating Net Cash-flow, Mio €</b>	<b>2018</b>	<b>4303</b>
	<b>2019</b>	<b>3497</b>

<b>Capital Expenditure, Mio €</b>	<b>2018</b>	<b>1458</b>
	<b>2019</b>	<b>817</b>

#### **Beyond your products, you are also dealing with the integration of nonfinancial ratios in your financial reporting - already long before sustainability has become a central theme. Do you see yourself confirmed?**

We are in any case a strong supporter of integrated steering, because we believe, that the financial ratios not alone decide about the long term success of the corporation. We are convinced, that also the social and environmental performance are essential success factors, and accordingly we have integrated these early on into our reporting. But also after ten years there are things which we can further improve.

#### **How do you perceive the response from the Investors?**

Very positively. In the last years, we could extend our share of socially responsible investors from 5 % to 15 %. There you can see, that this is appreciated. But we certainly have much greater influence as supporter of our clients regarding the reduction of their CO2 footprint, which is often much bigger than at a software corporation like SAP.

Here we see the chance, to take with us many customers with a change to S/4Hana and to give them holistic steering options - for instance when it is about reduction of plastics or about ideas re the circular economy.

**Are these steering possibilities for customers also relevant for their decisions about which software they use?**

We are just about noticing at our large customers, that they have a strong interest in co-innovations with us in this area. As we probably have the broadest product portfolio in our industry, we are already best positioned as partner. Insofar this is certainly a differentiation criterion, which from our point of view is also a competitive advantage.

**Which would certainly be bigger, if there would exist more standardisation regarding regulations of holistic measuring and reporting. What is SAP doing, in order to push this ?**

We have got together, for this purpose, with BASF, Bosch, Novartis and others in the Value Balancing Alliance, VBA. This initiative is open for others, and there are already talks with a number of Blue Chips, which will participate in the coming months. But I do not want to anticipate this. It is the objective, to get away from a corporation individual design of tying economic and non-economic business indicators to a general design. Here we bring in our experiences, and the VBA also takes other international organisations like the OECD into the boat. This must be so, when it is meant to become standards. For us it is interesting, to be part of it from the beginning, because then naturally at the end of it software must be written, which can support the entire project.

**SAP SE**  
**Shareholder Structure, as of March 6, 2020**

Founder Mister Plattner	6,3 %
Founder Mister Hopp	5,5 %
Own Shares	2,8 %
Free Float	85,4 %
Market Capitalisation, As of May 27, 2020	137,40 billion €

**Your own CO2 footprint has recently shrunk more slowly than hoped for. Was it due to the growing Cloud utilisation?**

Through the Cloud, naturally the energy consumption for computing power has increased as a trend. For us rather the strong growth of the business volume and concomitantly of our business travel were a challenge. We have here missed our objective, although we have once more lowered our CO2 emission. Thus we here have to endeavour more. But I am convinced, that we shall also get this done. Our computer centres, however, since quite some time are supplied by 100 per cent with green electricity. With this we can also offer to our customers, to reduce their CO2 footprint.

**Next to the CO2 emission objective, the Cloud also was detrimental to your margin for a long time. Until 2023, this one is planned to increase by good 400 basis points versus 2019. How is the Cloud contributing to this?**

The beautiful is: The Cloud is starting, to contribute to the margin improvement. In the next years, we shall continue to certainly have negative effects through the change in the mix of sales. The Cloud is though significantly more profitable than our Service business, but is still somewhat behind our business with Software Licenses. The difference though becomes smaller. The negative effect through the changed sales mix we estimate to be 400 basis points. But this will be overcompensated by the improvement of the gross margin in the Cloud business which contributes around 500 basis points to the margin improvement. With this around one percent of our expected margin improvement is already coming from the Cloud.

**Where is the improvement coming from?**

This is resulting essentially from two areas. On the one hand this comes from sales and marketing, where we can lower the relative expenses in relation to sales. This also is partly the result of our changed business model. In the Cloud we receive revenues through the renewal of contracts, for which we have less sales costs than for new contracts. In addition we have newly positioned our sales activities, and have got rid of parallel structures. Here we can make the management leaner. The biggest levers are however our partnerships with hyper scalers like Google, Microsoft, AWS and Alibaba. Through our acquisitions in the past years we had at first a non uniform Cloud infrastructure. Now we change over to a joint infrastructure. Accordingly, we do not have to erect great buffers. This gets us ahead with a significant step at the margin.

**This sounds as if you have computed the margin objective of 75 per cent in a way according to Pi times the thumb?**

(laughing) Pi times the thumb is not so much my thing. Of course here are the basis exactly calculated and realistic assumptions. And one can also say, that at SAP in the past years we have always set objectives, about which we were sure, that we would be able to attain them. So it may well be, that at the end an increment will come on top of it. With the Cloud margin of 75 percent we are comfortable.

**But from your point of view the 75 % are not the end of what can be achieved?**

No. We also see, that within the Cloud business the two units with stronger margins, the units Software as a Service (SaaS) and Platform as a Service (PaaS), by comparison to Infrastructure as a Service (IaaS) are increasing more strongly. Here the sales mix is supporting us. And in SaaS and PaaS margins of beyond 80 percent are absolutely achievable. This we see ourselves, but also at our competitors, who have no IaaS business: Gross margins of beyond 80 percent are possible.

**Margins like in the Software License Business are also possible?**

Sure. This is all a function of how much new business is part of it. When this is going down in relation to contract extensions, then also the margin is growing. Possibly, this margin can once again significantly exceed the margin in the License Business. However, I naturally hope, that this will not be the case as long as possible, because this would mean, that we would not grow any more strongly in the Cloud. Then I prefer, to now win more market share, and to increase the profitability strongly at a later stage.

**The chances for growth in the Cloud are probably still enormous on the basis of the enormous number of customers of SAP in the On-Promise-Business - quite without gains of market share.**

This is correct. We have the huge opportunity, to convert our customers more strongly into the Cloud over the years to come. This is only now really starting. In the fourth quarter we have concluded a great contract with one of our largest customers, who begins, to migrate into the Cloud. We expect, that this trend will extend itself in the coming years. And this is naturally a market potential, which is a multiple of what we could realize so far.

**Is the change over of many corporations on to the new Business Suite S/4Hana a suitable trigger?**

This is an accelerator, no question. The customers are naturally considering at such a change whether to make a simple migration and not to make use of advantages like the simplification, or whether they want to make a real renewal and thus newly think the processes. The latter one then suits very well with a Cloud Supply model. However, such a Greenfield Transformation means somewhat more work at the customer, so that it then can also last somewhat longer - especially at corporations, which are taking along very many ERP (enterprise resource planning) processes.

**Many customers had requested, to extend the maintenance period for the predecessor Suite 7. To this you have now agreed. Because the excitement about S/4Hana is still missing?**

We not only have extended the maintenance end from end of 2025 to end of 2027, respectively with the additional option till the end of 2030, but we have also given a maintenance promise for S/4Hana till end of 2040. This is in my view a uniquely long maintenance promise. Both are important promises, and I think, thereby the customers know, on what they can count at SAP.

**How is then in the meantime the adoption rate at S/4Hana?**

We have in the meantime, almost 14.000 customers licensed with S/4Hana. Actually of which 6200 have been switched live. In addition we have almost 3000 running implementation projects, of which presently many are shortly before introduction. We also have very big customers like Vodafone, who are already live, and who therewith naturally serve as reference for other customers. In the high volume telecom industry though the S/4Hana is also an ideal platform. We expect, that in the next 24 to 36 months on principle all large mainstream customers will have started their transformation projects with us. Who today lets train oneself as S/4 advisor, does not have to worry from my point of view, that one ever will have no work. Accenture, Deloitte, EY and the other big consulting corporations are massively hiring, and they also have a very big pipeline of S/4 transformations.

**Is here the described complexity not also a disadvantage for SAP compared for instance with Salesforce?**



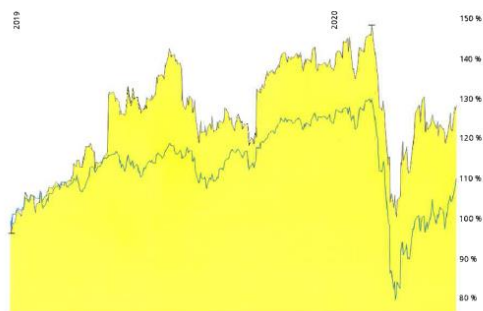
On principle, no, because SAP from my point of view must always be in a position, to be competitive with each single product. We have as an example many customers from Ariba, who get supplied their ERP product from Oracle. Naturally, the stronger integration of the SAP-ERP-systems are a plus. But if we would only rely on the sales of complete Business Suite packages, we would leave a large part of the market untouched. Also because the decision for S/4Hana not always is the first decision for a SAP product. Often beforehand Cloud solutions are being introduced, and the more costly S/4Hana migration comes later.

**SAP SE, 111,84 € Share Price as of May 27, 2020,  
German Stock Exchange Xetra**

Price Index Chart, Index-base as of January 2, 2019 = 100

-Black line: SAP SE Share

-Blue line: DAX German 30 Companies Large Cap  
Stock Performance Index



**Your shareholders, as regards the dividend, you did not have to feed off to a later date. Are you now lifting the pay out ratio permanently from at least 40 percent to over 50 percent ?**

Not so. It is obvious, I think, that the dividend is this high this year only for the reason, because the net profit as per IFRS was lowered by special expenses for our restructuring program. This naturally will not be repeated again in the same manor. When you are looking at our non-IFRS objectives, you can recognise, that we are expecting at the IFRS return an increase of at least 50 percent. We have always said, that it is an objective of SAP, to pay stable and rising dividends, and this we have done also this year. To this we naturally want to hold on in the coming year if business develops accordingly, even though not once more the pay out ratio will again be in the high fifties. But for the shareholders certainly counts also the absolute size of the dividend and not the payout ratio.

*“ we believe, that the financial ratios not alone decide about the long term success of the corporation ”*

**A special dividend is still beckoning to the shareholders by way of share buybacks with the amount of 1.5 billion Euro, a manageable sum with a view to your market capitalisation?**

Yes indeed. I think, though, that share buybacks especially in the presently difficult market situation is a good way, to create value for the shareholders. As of the day of publishing the share buyback, it was well accepted. The investors do appreciate, I think, that we stand to our promise made at our capital markets day in November 2019, and that we shall also envisage, in the coming years, and given a suitable cash flow, to make smaller buybacks.

**Another promise is the quick decrease of the increased indebtedness due to the Qualtrics acquisition. How are you proceeding?**

We were, at the end of the year 2019, with a ratio of net debt to earnings before interest taxes and depreciation (Ebitda) at a factor of 1.2. This is not a level, at which we should feel uncomfortable. At the end of this year we are planning, to be under 0.9, and 2023 we want to be in a sustained manor below 0.5. Even when we perhaps will not have the most efficient balance sheet structure in the market, will our balance sheet also in the future be constructed in a very conservative manor.

## About the Person Mr. Understatement

Until recently, the role of SAP-CFO Luca Mucic was quite clearly defined from the point of view of the investors. Next to Ex-CEO and super machine Bill McDermott the 48 year old had the job, to give a sober factual perspective on Europe's largest software group. This will be made available also without McDermott. "One can say, that at SAP in the past years we have always set objectives, about which we were sure, that we would be able to attain them", confesses Mucic with his preference for understatement. However the yearlong cooperation with McDermott has already left its mark. A formerly "half empty" glass now appears to him as sometimes "half full", he is smiling.

The CFO, who is in favor of a limitation of managing positions by active managing directors, is member of one supervisory board only, and this at Heidelberg Cement Group. An efficient choice, as the headquarter of the construction materials group is only 20 kilometers away from the SAP campus. And Mucic knows the city of Heidelberg best. Before he joined SAP at Walldorf, he had studied law at the Heidelberg university.

## Ethical Commerce

By **Lehana Nel**, Forensic Accountant – TS Namibia

A while back, I visited our local retail grocery shop again for our monthly list of items. Walking through the isles, ticking off my list, as I put my groceries in my trolley. At the fruit and vegetable section, a price tag for paw-paw's caught my eye, I picked up the fruit, went to the lady at the weighing station, to make sure that the price is correct. She assured me that, that is the correct price. Astonished, I took a photo of this fruit, with the price tag on. Later I then contacted the store owner, and asked him why the price of the fruit were so inflated. (More than 100% inflated) The store owner replied that he bought these fruits locally, and that the prices were much higher than the normal imports from South Africa. He resentfully corrected the price to a fair market value after our conversation, which were more than half of the price that I complained about.

The great ethical retailer, who died more than a decade ago, Anita Raddick was one of the pioneers in ethical commerce. She said that: "I want to work for a company that contributes too, and who is part of the community". Demanding that modern day retailers does right by society. Sir Marten Sorrel coined this phrase right after the economic meltdown after 2008: "Doing good, is doing good business".

According to the Namibian Competition Commission, close to 40% of the complaints received the last 4 to 5 weeks relates to the price increase for food, and basic consumer items. Whilst 25% of the complaints relate to the transport, motor vehicle parts, furniture, construction and accommodation sectors. 13% of the complaints are in respect of health and hygiene, hand sanitizers, immune boosters and face masks. 24% of the complaints relate to products or services which were not specified.

Ethics cannot be cherry picked. In this day and era, it gets harder to maintain ethos in our environments, with the internet at your fingertips, our profession is constantly under scrutiny, and sometimes over regulated, mostly because of the lack of deontological ethics.

Deontological ethics is to do right by the book, and by the book, I refer to the applicable laws. As a developing country who recently had one of the worst draughts in many years, now faces an economic decline of 25%, this was announced recently by our new Finance Minister Honorable Minister Ipumbu Shiimi. My thoughts frequently wanders off to what is our social responsibility towards this. In our economical and professional environment, should we not be the "Anita Raddicks" of our profession? Advocating and protecting protecting the public's interest.



**Lehana Nel**

Forensic Accountant – TS Namibia

## Consolidated reporting and the evolving role of the CFO

by **Marco Nicoli**, Former World Bank Sr Project Manager and currently Special Advisor to the Director of the OECD Development Centre for the Human-Centered Business Model and **by Alessandro Valente**, BBA, MA, LLB, currently works in the private capital group at UK-based law firm Harbottle & Lewis

### Introduction

The historic transformative process of the real economy toward a more sustainable path is in full swing and is becoming increasingly significant.

“Business as usual” cannot be regarded as a viable option anymore and “sustainable business” seems to be the only long-term option for all, not only for developed countries or for large enterprises. In the future, huge financial resources will be available to businesses that are transitioning toward producing an overall positive impact. As of now, the EU budget current proposal foresees €7.5 billion for the “green deal”, plus additional funds to be mobilised at national level both from public and private institutions and by institutional investors.

As a core component of corporate citizenship, transparency through “consolidated reporting” has now become the preferred method for communicating both the core values and the performances of businesses. The range of topics covered by businesses reporting has increased (or expanded) considerably in recent years, with companies allocating considerable time and resources to make their reports more comprehensive and meaningful for their own shareholders, managers,

And external stakeholders. As such, it is estimated that nearly 80% of the world’s largest companies produce corporate responsibility reports. This practice should not come as a surprise considering the general trend in the business world to push for sustainable and environmentally conscious policies.

Although the short-term objective of consolidated reporting is often limited solely to the communication of such values and policies, research has showed that, in order to produce long-term results, consolidated reporting needs to be the final step in a structured strategic plan which builds upon a solid foundation of sound and transparent core principles, coherent policies and practices and performance indicators. For such purposes, companies can use consolidated reporting as a benchmarking tool to measure their progresses and shortcomings, in addition to communicating their values to both internal and external stakeholders. The present article aims at contributing to this view, by supporting the idea that well-planned strategies which are built upon responsible corporate objectives are the optimal solution to develop sustainable and credible corporate citizenship strategies.

\* Editor’s note: The opinions in this article are the authors’ and do not necessarily represent the views of OECD and Harbottle & Lewis.

1 Yanis Varoufakis and David Adler, “*The EU’s Green Deal is a Colossal Exercise in Greenwashing*” (The Guardian, 7 February 2020) available at <<https://www.theguardian.com/commentisfree/2020/feb/07/eu-green-deal-greenwash-ursula-von-der-leyen-climate>> accessed 20/02/2020.

## Consolidated Reporting Process

Since the dawn of the 90s, pressures on businesses relating to transparency have increased exponentially, particularly in relation to the communication of their social and environmental impact. Despite originating from a variety of different sources, it is possible to identify four main factors which are responsible for this progressive raise in corporate responsibility and transparency. The first factor consists of the consumers, which are increasingly concerned about the ethical repercussions of their purchases. The second factor encompasses the shareholders, which are increasingly considering social and environmental issues into their investment decisions. The third factor is made of the external stakeholders, including financial institutions, business partners, local communities, and civil society organisations, which now pay attention to the overall value that companies contribute to society. The fourth factor comprises the workers who seek proof that their company is a responsible corporate citizen.

A direct result of these factors, the reporting on social, environmental and integrity performances, has pushed businesses to broader and more comprehensive accountability. Better known as “consolidated reporting”, this has been the most common format used by companies to present this type of information.

Although consolidated reports are far from being the only *medium* through which businesses communicate their policies, it is perhaps the most effective, since it describes values, policies, practices/actions, measurement methodologies and performance, they tends to be a recurring process. What makes consolidated reports unique is their double role of communication and performance management. Surprisingly, reporting has gone beyond its original scope of reassuring compliance with generally accepted principles of social and environmental respect. As such, it is becoming increasingly clear that reporting drives performance. In other words, businesses align the report with a strategic approach to interpret corporate citizenship, which ultimately boost performances.

However, as demonstrated through extensive research, limiting reporting to mere communication can clash with performance management. In essence, the information that a business communicates to its stakeholders often does not correspond to the information needed to boost performance. This friction can be alleviated by appreciating that the entire

process of reporting, while crucial to the profile of the company, cannot be considered a vehicle through which to achieve performance and should never be the ultimate objective. As such, a consolidated report should be part of a comprehensive management framework involving all levels of the organization, as opposed to an exercise solely aimed at communicating with stakeholders.

While transparency is the main driving force behind internal and external reporting, only an unfiltered approach to performances and objectives, shortcomings and achievements, enables consolidated reporting to show its true potential. Therefore, transparency alone is not enough, since efficient internal systems need to be implemented in order to translate what was discovered through the reporting process into actual improvement. This is precisely the challenge and ultimate objective for all enterprises engaging in consolidated reporting.

## **Evolution of the CFO's Role**

Such a radical change in the day-to-day running of a business would not be possible without the willingness by CFOs to begin implementing the necessary measures.

Whilst traditionally most of CFOs' focus is on financial performance, CFOs operating in today's business environment simply cannot ignore the need to seek sustainable policies and practices. Many large enterprises have made substantial changes to their bylaws to introduce a direct line of accountability of top management on sensitive integrity issues (i.e. corruption, money laundering, tax evasion, etc.).

The growing importance of sustainability will thus present growing challenges for CFOs in the future. The process of reporting on the social and environmental performances entails the development and creation of modern reporting systems and the adoption of more effective non-financial indicators. It is thus becoming increasingly complex for CFOs to aid their enterprises in taking strategic decisions that involve evaluating the trade-offs between the pursuit of social and environmental sustainability and financial performances. This generates a serious dilemma about the balancing of short-term and long-term goals and objectives.

Some enterprises have also introduced functions and/or professional profiles such as the Chief Compliance Officer (CCO), in charge of developing,



Overall, the fast-changing nature of business is causing companies to have to rethink both their values and communication strategies. Since the 90s, external pressures in relation to transparency have forced companies to introduce a new way of interpreting their mission, which has become increasingly tied with the perception of the public, and consequently of the companies' stakeholders. In this context, it is thus crucial for CFOs to match profitability with ESG factors in order to create a cohesive narrative which can set the way forward.



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With the term corporate citizenship the authors refer to a type of company that seeks to align its own interest with the interest of society. For a more deeper study of the concept see: Carmen Valor, “*Corporate Social Responsibility and Corporate Citizenship: Toward Corporate Accountability*”, available at <<https://onlinelibrary.wiley.com/doi/full/10.1111/j.0045-3609.2005.00011.x>> accessed 20/02/2020.

Whilst not all-encompassing, the term “consolidated reporting” has become an umbrella term to describe a plethora of standalone documents referred as social reports, sustainability reports, corporate responsibility reports, CSR reports, and corporate citizenship reports, integrity/compliance report, etc.

KPMG, “*Survey of Corporate Responsibility Reporting*”, available at <<https://home.kpmg/content/dam/kpmg/pdf/2015/12/KPMG-survey-of-CR-reporting-2015.pdf>> accessed 20/02/2020.

For more information regarding environmentally conscious policies see the “*OECD Environmental Risk Assessment Toolkit: Tools for environmental risk assessment and management*”, available at <<https://www.oecd.org/env/ehs/risk-assessment/environmental-risk-assessment-toolkit.htm>>.

“*Guidelines for Environmental Risk Assessment and Management*” available at <[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/69450/pb13670-green-leaves-iii-1111071.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/69450/pb13670-green-leaves-iii-1111071.pdf)> and the “*Environmental Risk Assessment (ERA): an approach for assessing and reporting environmental conditions*” available at <<http://www.env.gov.bc.ca/wld/documents/era.pdf>>.

Belinda Richards & David Wood, “*The Value of Social Reporting*”, available at <<http://iri.hks.harvard.edu/files/iri/files/value-of-social-reporting.pdf>> accessed 20/02/2020, 4.

*Ibid.*

Crawford Spence, “*Social and Environmental Reporting and the Business Case*”, available at <<file:///C:/Users/637/Downloads/rr-098-0020october2620072.pdf>> accessed 20/02/2020.

For more information on corruption see the “*Anti-Corruption Toolkit for Small and Medium Sized Companies*”, available at <<http://g20.org.tr/wp-content/uploads/2015/12/Anti-corruptionToolkit-for-SMEs.pdf>>, the “*SME Governance Guidebook*” available at <[https://www.ifc.org/wps/wcm/connect/topics\\_ext\\_content/ifc\\_external\\_corporate\\_site/ifc+cg/resources/guidelines\\_reviews+and+case+studies/sme+governance+guidebook](https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+cg/resources/guidelines_reviews+and+case+studies/sme+governance+guidebook)>, and the “*Anti-Corruption Third Party Due Diligence: A guide for small and medium sized enterprises*” available at <<https://iccwbo.org/publication/icc-anti-corruption-third-party-due-diligence/>>.

For “*ESG factors*”, the authors refer to the three central factors in measuring the sustainability and societal impact of an investment in a company or business.

The Association of Chartered Certified Accountants, “*The Changing Role of the CFO*”, available at <[https://www.accaglobal.com/content/dam/ACCA\\_Global/Technical/Future/pi\\_ACCA-IMA-changing-role-of-the-cfo-report.pdf](https://www.accaglobal.com/content/dam/ACCA_Global/Technical/Future/pi_ACCA-IMA-changing-role-of-the-cfo-report.pdf)> accessed 20/02/2020.



## The role of the CFO in a modern board

by **Anastasios Rodopoulos**, IAFEI Area President for Europe and Middle East and General Manager & BoD Member Hellenic Business Administration (EEDE)

The tone has got to come from the top, from the CEO and the Board general guidelines.

But if that isn't happening the next person down and probably the only person who can influence the CEO is the CFO.



**There are 9 main sections that a CFO has a great influence being a member of BoD.**

### 1. Regulation

CFOs now have an increasing personal stake in, and accountability for, regulatory adherence and compliance. They invest more personal resource dealing with regulatory matters and in engaging policy makers to ensure new regulatory requirements provide benefits to business.

Tomorrow's CFOs will need to play a role in preventing overly onerous and burdensome regulation. They will need to lobby on behalf of the business, put in place business processes and protocols that negate the need for more regulation, and influence relevant policy development. They will also need to ensure that the finance function has specialist expertise to resolve regulatory challenges.

**The level of compliance we need to deal with is a killer, for both small and larger companies.**

### 2. Globalization

The globalization of businesses has had a significant impact on the role of the CFO and physical set up of the finance function. This will be compounded in the future. Tomorrow's CFO relationships will be global, and often virtual. The days of off-the-record conversations in the corridor are diminishing

Expansion places new strains on the business, such as how to access finance in markets and ensuring adherence to additional local regulatory frameworks and requirements. The finance function will need to be adaptable as it streamlines different rules and regulations into business as usual finance activity and CFOs will need to establish how business expansion into new markets can be best supported by the finance function.

Tactical issues are one thing – culture and cross-border working relationships are quite another. With finance responsibilities increasingly crossing borders, the CFO needs to navigate through, and embrace a vision for, the finance function that cuts across different cultures, working practices, beliefs, languages and time zones. Global leadership will be the cornerstone of the future CFO's role.

**Serving global clients means we have to integrate more with our foreign partners in different countries. It brings a much greater level of complexity to the work that we do.**

### 3. Technology

At the moment, a key challenge for CFOs is that data systems and their hierarchies often do not reflect business structures or reporting needs. At the same time, the business continues to change, which means that technology plays catch up and finance spends significant time reworking data in spreadsheets.

Technological developments will serve to help gather, organize, standardize and make data timely. This will drive more effective business intelligence for identifying new market and profit opportunities, measuring and managing business performance, running simulations, or bringing customer insights.

Tomorrow's CFOs and their finance functions will need to be very adept in leveraging this technology. In theory this means less time on recording and verifying the numbers, and more time making the data connections and explaining the number implications to the business – applying the finance lens on decision making.

A big challenge right now is business restructuring and changes, and having to still rework the data to match those changes.

There is also the question of who owns responsibility for this great opportunity? Business intelligence and its successor, analytics, initially developed in the domains of computer science, information systems and marketing. Finance professionals are the business's natural analysts. To this end, we would expect analytics increasingly to fall within the remit and ownership of the CFO.

**We need to be able to rely on our data to a much greater extent, to get out of it insights to really take our conversations to the next level, especially in an increasingly global and competitive environment.**

#### 4. Risk

The risks are now on a much, much higher level and yet we still get requests from the business to focus on cost savings through things like headcount reduction. It doesn't make sense

For tomorrow's CFO, there will be greater scrutiny of the effectiveness of risk management processes, and much higher expectations on the adequacy of longer-term financial plans from the board. Investors and other stakeholders with a vested interest will also look for greater assurances over the financial viability of the business's strategy for delivering longer-term financial success and growth.

The tone has got to come from the top, from the CEO. But if that isn't happening the next person down and probably the only person who can influence the CEO is the CFO.'

The consequential relationship between poor corporate behavior and risk is all too familiar.

Tomorrow's CFO will be seen as the internal safeguard to a better corporate ethos. This does not mean to suggest sole ownership and responsibility belongs to the CFO.

The rest of the board must also play their role and set the tone from the top, but ultimately it is the CFO who is the guardian of the organization's assets and who should recognize that poor behavior can lead to value erosion.

Access to capital markets will also become an even greater priority for CFOs in the future. In a more volatile environment, and a more uncertain investment climate, ensuring the right balance of business funding will provide finance leaders with increasingly significant challenges.

Future CFOs will need, more than ever, to ensure appropriate policies in relation to capital investment, cash availability and shareholder return; balancing risk and reward effectively will be critical.

**One of the key challenges for the modern CFO is risk management. Avoiding risks is not an option. You have to be proactive and be prepared to take risks.**

#### 5. Transformation

Reducing costs, improving efficiency and becoming a better partner to the business – these are the typical aims of finance transformation and a key priority for tomorrow's CFO. The growth of outsourcing and finance shared services alone is testimony to the fact that CFOs are prioritizing the re-engineering and transformation of finance activities.

In many senses, the low-hanging fruit has already been picked. CFOs have adopted remote delivery models tapping into labor arbitrage in offshore locations to drive down cost, and centralized transactional finance processes to drive efficiencies, standardization, quality, operational agility and automation. Broadly, these initiatives have been successful.

Tomorrow's CFO will need to ensure finance is a catalyst for change across the business, driving outcomes that affect long-term business performance, not just short-term finance outcomes or one-off cost reductions. In this respect, there is much more that can be done

**In any outsourcing or shared service arrangement, you need to think very carefully about the risk you are bringing into the organization. If you do it right, however, you can drive the efficiency.**

## 6. Stakeholder management

For me to get to the table as a strategic partner with the CEO, and the rest of the senior team, first and foremost I have to deliver on the statutory and controllership responsibilities.

Tomorrow's CFOs will also increasingly need to be good at dealing with the media and at brokering the external relationships that matter for the face of the business. In many senses they will be the face of the corporate brand. They already fill this role with investors, but they will have a broader circle of business relationships, from their traditional partners – the banks, tax authorities, external auditors – through to customers, suppliers, supply chain partners and so on. They will need to embrace and use new media channels.

The new CFO is pretty much the only person in the new organization that is in a position to see all the connections and the bigger picture across the company. Everybody else has their own incentives. The challenge is: how do you get everyone else to agree with this holistic view of the business?

## 7. Strategy

Today's CFO is proclaimed equally a strategist and a numbers person. The responsibility for formulation of business strategy typically rests with the broader executive team, with CFOs playing their role as key members of the board. We can expect this trend to continue in the future.

The first thing you learn is that there is always something to do. The hardest part is choosing what you are not going to do. You have to be clear on the top organizational strategic priorities from the CEO, then you can figure out how finance can best support the organization. Harmonization, prioritization, communication is very important.'

Tomorrow's CFOs will also need to drive change programs that integrate and attune the finance processes of the organization to the strategy of the business more effectively. There is a broader point here about the integration of the finance function with the business.

A key frustration cited by CFOs in the roundtable events that supported this report was that the business was often focused on short-term cost improvements (eg, headcount reduction) to the detriment of longer-term strategic planning,

And that time was often misspent on activities that did not contribute to a more effective longer-term strategy. There was a sense in which a rebalance was necessary.

One of the major challenges with any large company is that its ambitions are often not aligned. One ambition may be cost reduction, another growth, a third using less capital, and so on. For a CFO in this type of environment that is very difficult because it means you have nonalignment of goals.

## 8. Reporting

Economic sustainability alone is not a sufficient condition for the overall sustainability of an organization. Recent public statements of organizational strategies routinely contain commitments to social and environmental objectives in addition to the traditional financial ones.

Increasingly the CFO and the finance function will need to be involved in investment decisions with social and environmental as well as financial outcome. The increased importance of corporate social responsibility (CSR) will present additional challenges for the CFO moving forward. Reporting on the social and environmental dimensions of performance, as part of a broader move towards integrated reporting, requires the design and implementation of new reporting systems and more intangible non-financial measures.

The bigger issue is that businesses often face a conflict in pursuing environmental, social and business goals. Increasingly CFOs need to be able to help their organizations evaluate trade-offs among these goals. Are businesses and CFOs sometimes paying lip service to CSR issues, particularly in a climate which is more challenging, and where the first priority is securing growth and profitability?

With additional reporting requirements there must be a balance that is struck between doing the right thing from a CSR perspective whilst not overloading businesses with compliance overload.

This raises serious questions about balancing short-term and long-term goals and priorities.

**Tomorrow's CFO will tread a fine line in managing these dynamics, and must be prepared to challenge decisions that are not in the long-term interest of the organization.**

## 9. Talent and capability

If one issue dominates the thinking of CFOs today, it is having access to, and keeping hold of, the right finance talent. The increasing involvement and interest of the CFO in talent development is testimony itself to the changing nature of the CFO role.

One of the major challenges is that the direct reports into the CFO role are increasingly specialized. So when the CFO moves on, there is a development gap in bringing the incumbent through to a much broader role.

Developing talent through a global finance function across geographic, language and cultural differences is an obvious starting point. The rise of virtual teams will make people development strategies more complex.

Instead of promoting up we are really trying to promote people laterally so they get the breadth of experience they will need.

### Conclusion

**Operational excellence, in the traditional roles of transaction processing and financial reporting, is now taken for granted.**

**The rules of the game have changed for CFOs, reflecting a more uncertain, dynamic and global economic environment in which their businesses operate. This is compounded by an extraordinary rate of technological change.**



**There have been identified nine key issues and emerging priorities affecting the future role of the CFO:**

- Regulation requirements are increasing and CFOs have an increasingly personal stake in regulatory adherence.
- The challenges of globalization are creating a need for finance leaders to develop a finance function that works effectively on the global stage and that embraces diversity

- Technology is evolving very quickly, providing the potential for CFOs to reconfigure finance processes and drive business insight through 'big data' and analytics.
- The nature of the risks that organizations face is changing, requiring more effective risk management approaches and increasingly CFOs have a role to play in ensuring an appropriate corporate ethos. There will be more pressure on CFOs to transform their finance functions to drive a better service to the business at zero cost impact.
- Stakeholder management and relationships will become important as increasingly CFOs become the face of the corporate brand.
- There will be a greater role to play in strategy validation and execution, because the environment is more complex and quick changing, calling on the analytical skills CFOs can bring.
- Reporting requirements will broaden and continue to be burdensome for CFOs.
- A brighter spotlight will be shone on talent, capability and behaviors in the top finance role.

There is a clear sense from CFOs that all these growing pressures and issues are keenly felt. This brings the question of how CFOs can best allocate their resources and time in the face of the huge and increasing responsibilities.

The challenges include prioritization and balancing short-term/long-term trade offs as businesses seek to reduce cost but also plan for growth longer term.

The changing role of the CFO also has profound implications for the global accounting profession and the skills that will be needed in the future; we can expect the traditional career paths of CFOs to evolve in new directions. The changing structure of global finance operations and the changing demands placed on the role will simply necessitate different types of experiences and skills.

**This future environment presents enormous challenges for CFOs, but it also provides a great opportunity for ambitious finance professionals seeking a rewarding and enriching career.**



**Anastasios Rodopoulos**

IAFEI Area President for Europe and Middle East



## Management accounting innovation drives corporate strategic transition

*by Lixia Tan, Executive Vice President and Chief Financial Officer of Haier Group*

### ABSTRACT

In the rapidly changing era of Internet+, the Haier Group is dedicated to transforming itself from a traditional home appliance manufacturer to an entrepreneurial incubator, and striving to build a platform based entrepreneurial ecosystem. This article discusses the continuous financial and organizational reform of Haier Group, and summarizes the practical experience of management accounting innovation with Chinese characteristics.

### KEYWORDS

Strategic transformation; Innovation;  
Financial reform; Organizational reform

### Changes and Transformation, Haier Never Stops

Since its founding in 1984, Haier Group has followed an innovative system centered on users' needs in order to drive its sustainable and healthy development. It has grown from an insolvent and bankrupt collective small factory to one of the largest manufacturers of household appliances in the world.

Today, Haier is committed to transforming itself from a traditional home appliances manufacturing enterprise into an open platform for entrepreneurship, building an 'ecosystem' in the post e-commerce era, which focuses on the development of a community economy, and operates on value exchanges among users, with integrity and business ethics as its core competitiveness, for the purpose of shared benefits for all. On its journey to the world's first brand of large household appliances, Haier has been experiencing a variety of changes – destroying defect refrigerators in public to demonstrate its commitment to quality, implementing reforms in its business structure, introducing the concept of market chain management, carrying out process reengineering as well as promoting independent operators. Since its inception, Haier has gone through four stages of development:

Brand building, business diversification, adoption of international practices and standards, and global expansion. It is currently implementing an internet-based growth strategy. Throughout Haier's growth history, the driving force of transformation and upgrading does not come from established strategies, but from continuous innovation. It is not the traditional lab innovation, but one that is driven by the market and end-users.

The wide application of the Internet reduces information asymmetry. The biggest characteristic of the Internet era is the 'zero distance' between businesses and customers. Firms must be flexible enough to satisfy the customers for their diverse, rapidly changing and demanding needs. More and more they find that 'to be Internet centric' does not mean that managers must have an Internet mindset, but that the enterprises must operate in a way that is lighter, faster and stronger, and that they can organize resources and work together efficiently to meet the needs of the users. Kevin Kelly foresees this classic feature of Internet enterprises in his book *New Rules for the New Economy*. He described the state of 'flux' in the network economy, moving from change to flux of changes, which overthrow existing things, and provide a hotbed for the birth of more innovations. These changes do not occur in any orderly manner, and will form a process of 'regeneration'. In the Internet era, established processes for management, if continued, may be able to avoid internal conflicts and disputes, but may also lead to increased bureaucracy within the company. Production and R&D are on schedule. Business units and their staff are only responsible for the process, not for the results. In this way, the innovation ability of the firm will surely decline. At this time, internet-based transformation is no longer a selective but a question that must be answered. A right answer would be essential to the survival and future growth of the business.



# Organizational Reform Provides Strong Support for Strategic Transformation

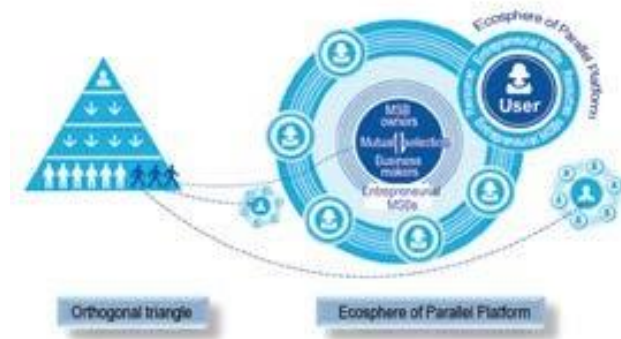
In the course of Haier's development, Mr. Zhang Ruimin, Chairman and CEO of the Haier Group, had put forward a model that aims to align the initiative of individual employees with value creation for the customers. The innovative business model, referred as 'Ren Dan He Yi', for short, encourages each employee, on an individual basis, to be more entrepreneurial and innovative in creating value for the customers, and share the benefits during the process, in a win-win situation for the company, the employees and the customers. In other words, Haier asks its employees not just to 'do things for the sake of the company', but to 'work for themselves'. As a result, Haier Group has gone through a transformation from a traditional hierarchical company to an 'open platform for entrepreneurship'.

It was a choice that Haier made in the Internet era to rid itself of the self-closing system found in traditional enterprises and become the network node of the Internet. It has transformed from a traditional household appliance manufacturer to a platform of incubation open to the whole society.

As shown in Figure 1, instead of being the traditional 'equilateral triangular organization', Haier is a platform consisting of many entrepreneurial and innovation teams today, which Haier calls 'Micro & Small Businesses' (MSBs). Haier has granted them the full power for decision-making, profit sharing and hiring.

At the same time, resources are made available on Haier platform to provide continuous support to MSBs for their entrepreneurship and growth. When the resources of the whole organization were deployed on the network, the organization becomes a true 'platform' with open user interactions, supported by an influx of resources. In short, it is 'an enterprise platform, where employees make products and serve customers with customized solutions'. In this case, there are only three types of people on Haier platform: platform owners, MSB owners and business makers. They bid for orders on their own on the platform. They are evaluated, and paid by the users out of the added value they created for the customers.

Li Yanbing, Li Ning and Li Xin are members of a team at Haier who happen to have the same last names, hence referred to affectionally as the 'Three Lis'. The three



Millennials have worked together and created the Raytheon game notebook, which has gained great popularity among game users. With the Internet interactive platform, the MSB team they set up collected an enormous amount of user data, which was used in combination with OEMs and design resources. In just two years, the Raytheon game notebook became a 'unicorn' brand with annual sales of more than one billion yuan. In fact, the 'Three Lis' is only one of the many examples of Haier Group's transformation to a platform-based organization. At present, Haier platform has more than 200 entrepreneurial MSBs, over 3800 sole proprietors and millions of micro shops, leading to a high concentration of capital and human resources. More than 100 MSBs have over 100 billion yuan in revenue

Revenue: CAGR in past 10 years is 6%

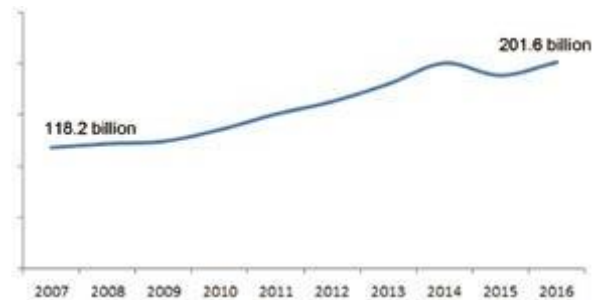


Figure 2: Income Trends of Haier Group in the Past Ten Years

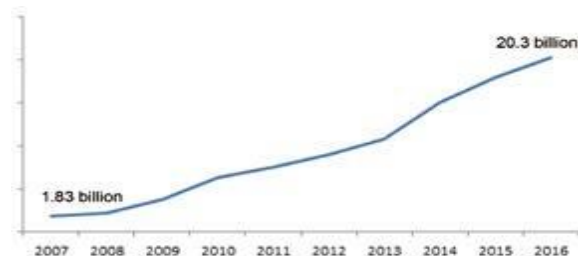


Figure 3: Trends in Haier Group's total profits over the past decade

41 MSBs have received venture investment, of which 16 were at over a 100 million yuan valuation.

Haier Group's strategic transformation to a platform-based enterprise began to pay off. While it is in the household appliances industry with low profit margin, Haier Group has been growing at a rapid pace for the past 10 years (as shown in Figures 2 and 3). In 2016, it achieved a global turnover of 201.6 billion yuan, an increase of 6.8% over the previous year, with 20.3 billion yuan in profit, an year on year increase of 12.8%. Profit has grown 1.8 times faster than revenue.

Transactions generated by the Internet in 2016 amounted to 272.7 billion yuan, an increase of 73% over the same period in the previous year. This number includes not only transaction volume generated by the sale of Haier's household appliances, but also the B2B/ B2C transactions on Haier's online platform, as well as the transaction volume generated by Haier's third-party payment and online wealth management. The latter two are undoubtedly the results of Haier's transformation.

### Haier's Financial Reform

The importance of the finance department in the process of business transformation is self-evident, because the ultimate goal of transformation is to pursue excellence and achieve a win-win result for the company, employees and stakeholders, and its realization would need the participation of the finance department. Haier's financial transformation began with the transformation of personnel and organizational structure. Before the transformation, Haier's financial personnel were basically divided into three categories: basic finance, professional finance and business finance. Basic finance mainly includes accounting, bookkeeping and other basic functions, and they were a major part of the financial management system, for about 70% of the total. The functions of professional finance mainly include capital management, budgeting, and mergers and acquisitions, for about 20%. Business finance is supposed to help marketing, research and development, production and other departments in their decision making process, accounting for about 10% of the total number. Such a financial personnel structure is very common in Chinese companies. Accountants play an essential role in financial management, putting in a huge amount of time and energy 'crunching the numbers after the event'. Due to the lack of sufficient business finance personnel and market insight, operation departments were not

Able to get strong business support from finance. As a result, Haier's financial department 'often scored the lowest on service satisfaction in Group wide evaluation. Everyone in the department worked very hard on repetitive jobs, but their efforts were just not recognized'.

With the launch of the 'Ren Dan He Yi' model, transformative changes began to take place in financial organizations. In this model, every Haier employee becomes his own CEO, creating value for users and realizing his own value at the same time. Under the guidance of this strategy, Haier Finance began to transform from its traditional accounting function to that of management accounting. In order to realize the strategic transformation of the company, Haier Group's financial team has begun to examine the value of finance from a broader perspective with a more forward- looking approach. Building on the strategic transformation across the company, it has repositioned itself with the goal to 'plan for the future and lead the efforts for win-win solutions'. It has implemented subversive changes in the financial management system to make it one that 'plans to win', as a contributor to the implementation of Haier's corporate strategy and its management model, and a leader in the management accounting reform.

With the 'plan to win' principle, Haier has reorganized finance into four modules: strategic finance, business finance, professional finance and shared finance. There have been major changes in personnel structure as well. About 70% of the personnel work in strategic and business finance, 10% in professional finance, and the number of people in basic finance functions dropped to about 20%. Such changes were the results of major shifts in functions in financial organizations: first, as management accounting had taken up a more important role, many accountants were reassigned to this function, basically moving from the back offices to the front to become business accounting partners. This led to the second change, i.e. a much enhanced business accounting function in a fundamental transformation of the structure of the finance department. Third, instead of being concentrated in one department handling basic accounting and reporting, accountants have become more integrated with business units and are now working more closely with them in different areas to find opportunities and create value. They play a catalyst role to business departments as they work to solve problems, all for the purpose of planning to win.

These changes also embody two principles in the design of the organizational structure: an increased level in both centralization and decentralization.

First there was an increased centralization of strategic finance, which is responsible for the goals, approaches, policies, resources and risks of financial management of the whole group. The second area of increased centralization is shared finance. Before, Haier's accountants were staffed for different organizations and processes, with 1800 people strong, located across the country. As a result, workload was uneven, with some being extremely busy, while others not having much to do. Haier Finance has broken the barriers of organization, time and space in the process of reform. Accounting is now processed in a centralized manner on the cloud platform, which reduced basic accounting staff to 240, and improved efficiency by nine folds. With boundaries of functions removed, financial documents that need to be processed are now all placed on the cloud platform, and accountants can just log in and sign up for jobs. The more you do, the more paid you will get. As a result, work efficiency per person has increased by two folds. Decentralization took place in business finance, as the finance staff moved from the back offices to the front to work together with the MSBs, providing support to them in their decision making and helping them create value and achieve

sustainable development. Professional finance, on the other hand, provides their professional services in taxation and capital management, and helps to grow the MSBs by establishing appropriate processes and rules.

From 2012 to 2016, Haier's revenue increased from 160 billion yuan to more than 200 billion yuan, with also an increase in the number of incorporated companies, from 600 to more than 900. From 2007 to 2016, total profit increased from 1.83 billion yuan to 20.3 billion yuan. All of these are the result of Haier's financial reform. At present, Haier's Center for Shared Finance has 120 standardized sub-processes in 12 categories, and has become the only such center in China with the most business processes, covering extensive areas, with the highest efficiency.

In fact, the financial team was not the only one that had gone through the transformation. In order to promote the transformation to a 'platform with MSBs', the Haier Group decided, in a very creative move, to tear down the 'walls' between various functional departments, and integrate business functions in the forms of platforms. Such as platforms for finance, human resources, information technology, legal affairs, etc. which constitute a large platform shared by all.

As a result, traditional functional departments no longer exist, replaced by the platforms that provide efficient, standardized and professional services, in support of entrepreneurship and MSBs. In addition to the services, there are also rules and processes set up to ensure that the platforms function in a dynamic and orderly manner, serving as a vehicle for Haier's strategic transformation.

### **leading Industrial Transition with Management Accounting**

In his keynote speech at the Global Alumni Forum organized by Wharton School of the University of Pennsylvania, Mr. Zhang Ruimin, Chairman and CEO of the Haier Group, had this to say; 'Management accounting, in the final analysis, is accounting for managing and planning for the future. Management accounting would be something full of vitality if it involves everyone working together to plan for the future, and their plan is also linked with everyone's own future.' Haier's transformation is closely related to management accounting. As a key link in the implementation of the company's strategy, management accounting must closely follow the strategic objectives of the company and drive for continuous optimization and improvement, for the final achievement of the strategic objectives, with maximum value creation and sustainable development. Haier has developed useful experiences in its innovation with management accounting, most notably the 'two matrixes'. The first one, named the 'Win-win Value-added Table', is used to measure the value of the ecosystem as all participants work to grow and create added value on the newly established platform. The second matrix is called a 2-D lattice table, and it is used to measure the competitiveness of each MSB, essentially if they have a clearly defined strategy and how it is implemented.

### **2-D lattice Table**

As mentioned above, Haier has granted full power to the MSBs. Each MSB has the power for making business decisions on their own, and setting up their own policies on distribution and human resources. Each MSB determines its own goals for the market and the path to achieve them. Then how can we make sure that they will create the greatest value they can? How to make sure that the value they created is aligned with the value for the users, without any conflict or deviation? That's the background under which the two-dimensional lattice tool was developed.



The two-dimensional lattice table is a quadrant consisting of a vertical axis and a horizontal axis (see Figure 4). The horizontal axis represents the goals that the MSBs will try to achieve for their market positions, and the boxes reflect their performance or competitiveness. The goals were not determined by the leadership, but were developed on the basis of industry standards. They were set to measure the competitiveness of the MSBs in the industry, not for them to compare among themselves. The vertical axis represents the strategies for achieving market

competitiveness. There is a causal relationship between the vertical and horizontal axes. The strategies will be important factors to increased competitiveness, and the result in turn will verify if these are the right strategies. The value is the function of a good strategy and a stronger position in competitiveness, as reflected in the boxes. For example, even if an MSB has reached a stronger position on the horizontal axis, it may not be a valuable business if it followed the traditional approach of promotion and advertising instead of effectively communicating with the end users at the front end. Such a matrix was developed to encourage every MSB to interact more with the users, so that they can make products that truly meet the needs of the users and create value both for themselves and for the customers.

### Win-win Value-added Table

As we all know, changes in models of organization and management mean that the tools would need to be updated as well. This matrix, the 'Win-win Value-added Table', is a tool to help realize and test 'Ren Dan He Yi', Haier's new business model. It is an important tool for Haier to transform to a platform-based ecosystem with successful MSBs. Traditionally, the outcome of business operation was reflected in a profit and loss statement with revenues verified from sales. The whole transaction was all about sale, and business would end after the product was sold to the user. As the enterprise has transformed into a platform, product sales and interactions between the business and the users are just the beginning of the transaction. With these interactions taking place on the platform, there will be continuous transactions involving multiple parties for products and services as well as different transactions in the ecosystem. As shown in Table1, this matrix represents a total shift of emphasis for the company, from the previous focus on the business only to the customer centric approach

Today, from a closed system to an open platform, from the top-down management structure to an ecosystem with users working and interacting with each other, and from accounting after the event to the creation of value shared by all stakeholders.

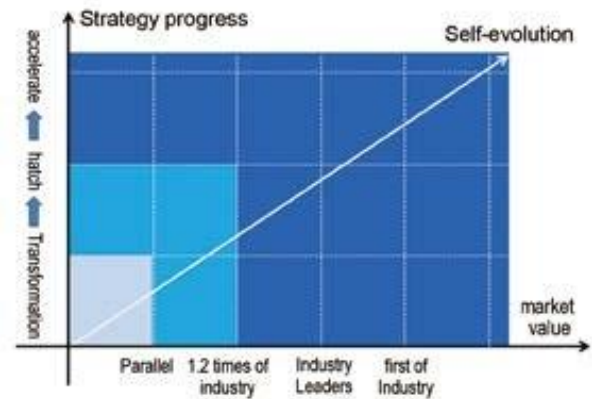


Figure 4: Two-dimensional lattice table

Table1: Comparison of traditional profit and loss statement and win-win value-added statement

Traditional Income Statement	Win-win Value-added Table
Self-centered	User-centered
Closed system	Stakeholder involvement in creating the best user experience
Top-down series	Full process parallel connection
one-sided market	Bilateral Market

This matrix evaluates and validates the MSB entrepreneurial model in five areas: user base, added value for the users, revenue, cost and marginal profit. The first thing that the matrix looks at is user base, which doesn't mean the amount of foot traffic. It must consist of users who participate in the whole process, including design, user experience, product iteration and upgrading, to form a complete ecosystem. If an MSB has no user base or a very small number of customers, it means it is still following the traditional way of selling products. Added value for the users is a key indicator in the matrix, which is used to measure whether an MSB can grow with value and profit that is substantially greater than the usual approach in traditional industries, to create value for all stakeholders. As a result, MSBs will be under pressure to constantly innovate and look for differentiated business models as they leave the old ones behind.

Revenue is the direct representation of value derived from the user base, which includes revenues from hardware and the ecosystem. The bigger the user base becomes, the greater the revenue from the



Ecosystem will be. With an increasing number of participants in the ecosystem, the platform proves to be one with lots of traction. The matrix also looks at costs, which are the resources invested to create value for the users, including hardware and the cost of building the ecosystem. Marginal profit refers to profit per unit (product/user/capital).

### A user Case of the Win-win Value-added Table – xinchu, an MSB that Drives Value Creation in the Ecosystem

In May 2015, Xinchu was established as an MSB on Haier's Incubation Platform. It launched its first product, the first generation of internet connected refrigerator in the world. It has all the functions of a traditional refrigerator, but it also has a touch screen that is connected to the internet, with functions for e-commerce, entertainment and the choice of recipes etc. A piece of hardware in the kitchen has created an ecosystem with different activities.

Shortly after it began the product development, Xinchu built a tribe of fans for the refrigerator through Wechat, the Xinchu APP, Weibo and other channels, where Xinchu interacted with users in the Food and Health Interest Group, and in discussions on after-sales service and online and offline activities. In order to bring the users the best of experiences, Xinchu's software system had been iterated for more than 300 times from its launch in June 2015 to the time of its IPO, and in some cases for 3 times in just one day. Such iteration speed is unimaginable for traditional refrigerators. On the fifth day after the product launch, the first third-party payment occurred a user in Beijing purchased a bag of rice through the e-commerce platform on the refrigerator. Data collected from the refrigerators showed that there were about 20-30 transactions on average per day, per household, which was about 70.6% in activity rate, 7 times higher than the industry average. On a monthly basis, activity rate was 94.4%, 4 times higher than the industry average. At present, Xinchu's APP has included 27 suppliers, as part of the larger Xinchu ecosystem. These businesses value the close interactions between Xinchu and its users and believe that they can make their own contributions. Xinchu is different from the traditional e-commerce in three aspects: first, it is an user interaction platform based on the Internet of Things; second, it emphasizes integrity with standards to make it a competitive platform based on integrity; third, it focuses on high-frequency consumption, providing

professional and best user experience in fresh products and other daily necessities. Instead of taking the traditional approach of simply selling products, Xinchu followed the indicators in the matrix and moved to a different direction as it focused more on acquiring customers and attracting more stakeholders to the ecosystem where all work together to create value and provide the users with the best experience.

### Conclusion

In the fast changing era of Internet+, the Haier Group has made great efforts to transform itself from a traditional home appliance manufacturer to an entrepreneurial incubator that is open to the whole society and a platform with an entrepreneurial ecosystem. In the process of strategic transformation, Haier has gone through a lot of changes, including changes in its financial strategy with the adoption of management accounting, which has allowed the company to develop valuable experiences in innovation in the Chinese context. These innovations happened first because of Haier's mindset for entrepreneurship and a sense of crisis it has maintained for more than 30 years. Second, it occurred thanks to its deep understanding of the changes in industries globally and its plans for its own growth. As Guan zi, a well-known ancient Chinese scholar said, 'Be persistent and you be able to rule everything'. Haier will keep moving forward as it continues its exploration in management accounting and strategic transformation.

Haier's revenue	Number of incorporated	Total profit
2012	companies	2007
160	2012	1.83
billion yuan	600	billion yuan
2016	2016	2016
200	900	20.3
billion yuan		billion yuan

## COVID19: Testing the EU a free appeal by the academic world

*by Peirgiorgio Valente, Chairman of the IAFEI Technical Committee*

### Modern Society Under Intensive Care

2020 will be remembered as the year of the COVID19 pandemic.

It has been already a couple of months that coronavirus has simply overturned all aspects of human (everyday) life everywhere around the globe. It has put large question-marks to what billions of people considered certain, normal, standard and given and is preaching to change human society for ever.

COVID19 is the global disease of a globalizing world that cannot react in a global manner. It is the challenge to globalization's spirit, having given rise to nationalistic policies, fragmentation, lockdown and distancing in every sense.

What is the right social and health policy? How far can fundamental freedoms be restricted? How much can personal data be penetrated? How should human relations be safely structured? How shall the world survive one of the worst economic recessions ever emerged?

The debate is heated all around the world. It seems, then, irrelevant, if even possible, to focus on any topic that is not connected with the COVID19 crisis. This note will therefore seek to contribute to the global debate.

In particular, this note concentrates on the European Union (EU), where the crisis is also taking a serious political dimension. Member States seem unable to agree common policies on the measures to deal with the health dimension as well as on the way to deal with the economic depression arising.

The very sense of the Union seems overshadowed by national sovereignty.

The extreme situation the EU is under is pointing out its limited capacity and threatens to destroy it. COVID19 seems destined to be the deadlock point, where the EU shall need to take decisions long postponed.

Wishing that this will be the opportunity to resolve on a common future of a strong, ambitious, solid and solidary Union, the community of the Link Campus University of Rome launched an appeal to all those who share the EU dream. The text below is a free translation of the original Italian text.

### The existence of the EU – A free appeal

We, European citizens committed to the future of the European Union, are concerned by the clear disparity between the objective and the capacity of the tools put in place to overcome the COVID19 emergency in the EU.

Without solidarity and common political spirit in the EU, we are alone.

The EU is called to radical choices. The COVID19 emergency poses a threat to the very existence of "our" Union. Together with the health dimension, there are deep social and economic consequences asking for joint responses. This time demands a clear and consistent behavior by the EU. In such a dramatic moment, we, European citizens, cannot accept delays, conflicting decisions and public statements.

We share the position taken by the Italian President Sergio Mattarella and by other EU Heads of State

Without a common front, if European institutions and Member States do not stand together, the Union envisaged by the Founding Fathers will be shattered.

European institutions - voices of the people of the EU, our voices – are called to a common responsibility. We support the stance of the European Commission towards the suspension of the European Stability Pact.

This free appeal to all those who want a common destiny for the EU is meant as a strong signal of concern, which can be accompanied by sectoral debates and in-depth analyzes.

The emergency we are all experiencing together cannot be a source of separation. But the opportunity to reconsider what it means to be “European”. Politicians, together with experts in culture and science, must act promptly.

The existence of the Union as common destiny, the social cohesion of Member States, are at stake. Member States cannot win alone. Only in the EU dimension, can we overcome this crisis. Only as EU can we transmit the positive message of a common future on a shared plan to relaunch our economies based on sustainable relations among EU Institutions, Member States and us the people.

There is a clear risk for our conscience as citizens not to keep pace with Institutions if they act from above.

The Commission's approach and certain Member States' stance are in the right direction. But we need action.

Aware that appeals are not enough, believing in our ideas, we are collecting proposals in this direction, which will be published as soon as received.

### Conclusions

COVID19 is much more than a health crisis. It is a challenge to modern culture, economy, social and political systems, the foundations of modern human society.

The virus has penetrated the very way of living of humans all around the world. It is pointing out the inconsistencies and loopholes of a globalization in progress. This is even more clear in an EU reality,

where no common way forward has been found in weeks of crisis and emergency.

But there is still the positive scenario. Crisis can always inspire new and stronger beginnings. This may be the opportunity for the EU to face its deficiencies and find cures. This is what the free appeal above aims at.

Going further, this may be also the way to a more solid and solidary global world. Common problems need common solutions.



**Piergiorgio Valente**  
Chairman, IAFEI International Tax Committee

# SOUTH AFRICA

## Leadership in times of crisis

*by Jacques van Wyk, CEO, JGL Forensic Services, Member of  
IAFEI Technical Committee Working Group*

American author James Lane Allen famously said, "Crisis does not build character, it reveals it." It also, as has been shown by some of the world's leaders during the Coronavirus crisis, reveals a lack of it!

It is, of course, easy to bash the crisis leadership shown by some (and there is sadly no shortage of examples where it's absolutely appropriate to do so). But we also need to understand that leading effectively right now, in the middle of a global health and economic crisis the likes of which we have never previously experienced, is no picnic.

But what does high quality crisis leadership actually look like?

Retired Lt. General Nadja West, former commanding general of the U.S. Army Medical Command, and now at the Harvard Kennedy School's Centre for Public Leadership, says, "leadership is the process of influencing people by providing direction and motivation to accomplish the mission and improve the organisation. During good times, you have to establish trust, then it's easier to ask people to do things when there's a crisis."

American writer David Foster Wallace called real leaders "people who help us overcome the limitations of our own individual laziness, selfishness, weakness and fear, and get us to do better, harder things than we can get ourselves to do on our own."

The coronavirus pandemic is placing unprecedented demands on political and business leaders. Many are calling the outbreak a "landscape scale" crisis, which is, as described by Herman Leonard and Arnold Howitt in their paper *High Performance in Emergency Preparedness and Response: Disaster Type Differences*, "an unexpected event or sequence of events of enormous scale and overwhelming speed, resulting in a high degree of uncertainty that gives rise

To disorientation, a feeling of lost control, and strong emotional disturbance."

A better description of our current situation you could not wish to find.

It is clearly a time when we are all hungry for strong, decisive yet compassionate leadership. Sadly, some of the world's leaders have let us down badly at a time when we needed them the most:

**Stella Ndabeni-Abrahams, Communications,  
Telecommunications and Postal  
Services Minister**

South Africa has stricter lockdown laws than many other countries, but for the most part, we are being good citizens. We stick to the rules, only go out when absolutely essential, and only buy the very basics of what we need. We don't see our friends or our families unless they live with us.

Unless, of course, you happen to be Stella Ndabeni-Abrahams. Our esteemed minister thought it was no problem to break lockdown and attend a lovely lunch at a friend's house.

Unfortunately for her, her host, ANC national executive committee member Mduzuzi Manana, posted pictures of the lunch gathering on social media.

Despite her apology and being put on two months' "special leave," the incident has left a very bad taste in a lot of South Africans' mouths.

**Dr Catherine Calderwood, Scotland's Chief Medical Officer**

Dr Calderwood ignored her own advice and made not one, but two trips to her second home



– an hour's drive from her primary residence – during the Coronavirus lockdown in the United Kingdom. During her first trip, she was spied by a photographer from the Scottish Sun newspaper, and subsequently received a warning from the police. This did not deter her from making a second trip to the same house with her family a couple of weekends later.

Despite Scottish First Minister Nicola Sturgeon saying that Calderwood had made a mistake but should stay in her job, the public outcry was too great. People were understandably outraged when the same women who had appeared on numerous radio and television ads urging the public to stay at home to protect the NHS and save lives, brazenly flouted lockdown on two occasions. Dr Calderwood has now resigned from her post.

In the book *Leading Consciously*, Debashis Chatterjee writes, "The credibility of a leader [comes from more] than his or her words. Credibility comes from character. If a leader demonstrates consistency in the smallest of actions, he or she is likely to demonstrate this consistency in larger actions. Credibility of large magnitude comes from credibility in small actions."

Take note, the Ndabeni-Abrahams and Calderwoods of the world.

Fortunately, we also have notable examples of good leadership in a crisis, one of which is our very own President.

### **President Cyril Ramaphosa**

Although it's true that, "one swallow does not a summer make," President Ramaphosa's response to the Covid pandemic has been applauded both within South Africa and internationally.

Professor Mcedisi Ndletyana, Political Analyst from the University of Johannesburg, said, "I would have hoped the President would have led like this for the past two years and not waited for a catastrophe of this kind to provide stern and decisive leadership. But President Ramaphosa has been decisive in closing borders and instituting a national shutdown. If this boldness and decisiveness stays with us, this President could do very well."

### **Lt. General Fabian Zakes Msimang, Chief of the South African Air Force**

Although not directly involved in the Coronavirus response, Lt General Msimang gave an inspiring speech on leadership to graduates of the University of South Africa in Tshwane in December last year.

He said, "I suggest and emphasise that all academic studies should include subjects of ethics, psychology and accountability as compulsory modules. Intelligence and academic excellence

without a moral compass is a dangerous use of resources. Let us prize integrated public servanthood and ethical leadership in both the private and public sectors. Moral standing is as valuable as oxygen."

We couldn't agree more!

When the Coronavirus pandemic is finally under control and the dust clears, we'll have a much clearer picture of the way in which our global leaders actually navigated the crisis. We'll also see who displayed truly great leadership and who was found woefully lacking. This will be the stage when strong leaders will admit any mistakes they might have made, and create workable plans for how things will work going forward. Weak leaders will be more concerned with covering up or justifying their mistakes, and will miss out on a valuable chance to win back lost support.

Paul Ntokozi Buhali, 1st Senior investigator at the South African Post Office, believes leaders should be taking steps now to mitigate the effects of any fraud, theft and corruption occurring during the Covid-19 lockdown that will inevitably come to light in post-pandemic audits. He offers these suggestions:

- Exercise a zero-tolerance approach towards unethical behaviour.
- Set out the responsibilities of management, supervisors, employees and other stakeholders pertaining to the prevention of acts of criminality, dishonesty and other misconduct.
- Re-enforce accountability duly vested in management and supervisory personnel to ensure compliance according to the legislation, policies and procedures in the various departments for which they are responsible.
- Establish a confidential platform for reporting criminal activities and identifying the culprits (wrongdoers).

- Implement a control process within that specific environment that is responsible for accountability.
- All implemented processes should be cost effective and be within the set procurement processes.

At the end of the day, good leadership will always be good leadership. It may take a crisis to reveal it, but when all is said and done, it really does come down to character.

JGL Forensic Services is a multidisciplinary team of experienced forensic accounting and investigation professionals. We strongly believe in the rule of law and the scientific method as it applies to forensic accounting and investigation. [Talk to us](#) in confidence, and let's work together to prevent corporate corruption and fraud.

**We are working remotely throughout the lockdown period and can assist you!**

Please take care, and look after yourself and your loved ones.



**Jacques van Wyk**  
CEO, JGL Forensic Services, Member of IAFEI Technical  
Committee Working Group

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