

BUSINESS IN THE NEW ENVIRONMENT

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I am extremely grateful to the Institute of Chartered Accountants of Pakistan (ICAP) for inviting me to address this august gathering. I do not remember as to how many times I have addressed the institute organized events but this respect for your profession in my heart has arisen because of the high professional standards you have been able to maintain. It gives me immense pleasure when the employers in UK, Middle East tell me that they would be more than happy to hire Pakistan qualified Chartered Accountants because they are well trained. I commend to other professional bodies in Pakistan to follow in your footsteps and escalate their professional standards to the levels you have demonstrated.

This morning I will make a few observations about the changing landscape of the global economic environment and in light of these changes the adjustment in their role the Chief Financial Officer (CFOs) will have to make.

There are four broad trends in the global economy that are stirring at present and about which we should be fully cognizant. The global economy power balance is shifting from the U.S., Europe and Japan to Asian countries. The crisis of 2007-08 did not substantiate the hypothesis of decoupling between the advanced and emerging economies as the spill over and contagion effects were quite destabilizing. The speed, intensity and spread of financial and then real economy crisis were too ferocious to spare any country of some consequence. But the resilience and the rapid recovery shown by the Asian countries particularly the three most populous countries China, India and Indonesia accounting for population of almost 3 billion was simply remarkable. China has resumed its past growth trajectory and is likely to attain 8.4 percent in 2010 while

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India is projecting growth rate of over 7 percent and Indonesia slightly below these rates. China has overtaken Germany as the world's largest exporting nation and that too starting from almost a scratch thirty years ago. Pakistani businesses have therefore to set their sights on their Asian neighbors rather than continue to be tied to the apron strings of the western countries.

The second insight gained from the global financial crisis is that the countries such as China, India, Pakistan, Bangladesh that pursued a path of cautious liberalization and exerted strong regulatory oversight and prudential norms on their financial institutions, did not permit exotic derivatives such as Collateral Debt Obligations and naked Credit Debt Swaps were left largely unscathed from the onslaught of the financial tsunami of the last two years. Too much reliance on unfettered markets and the premise that markets are self correcting have brought a lot of grief to the western countries. It is perhaps time for them to revisit their regulatory mechanisms and learn from the experience of the Asian countries. The global financial system has to serve the needs of the real economy rather than have a self propelling path of its own.

Third, the information explosion, the ease of access to internet, the increase connectivity have created a situation where the sifting of right data to support business decisions, ascertaining the accuracy and reliability of the data and utilizing the relevant data for analysis and judgment calls has become an enormously complex task. According to the latest Economist magazine, 150 billion gigabytes of data was created in 2005. This year, it is estimated that the number will cross 1200 billion gigabyte. "Merely keeping up with this flood and storing the bits that might be useful, is difficult enough. Analyzing it, to spot patterns and extract useful information is harder still. Even so, the data deluge is already starting to transform business, government, science and everyday life."

This exponential growth in availability of data and information will have serious repercussions on the way the businesses start, survive and compete in the global economy.

Fourth, the world is becoming increasingly conscious of the risks posed to human lives and prosperity by climate change, environmental degradation and natural resource depletion. IN the last decade, the scientific evidence has crystallized, the economic analysis of costs and benefits has become more convincing and the political consensus that something needs to be done has become more broad based. Therefore the notions and measurements that have so far guided the businesses will become irrelevant and new measures that look upon sustainability will have to be developed and pursued.

Such is the global context in which the Chief financial Officers (CFOs) will be operating in the future. This demands that they have to adjust and adapt themselves and their professional tools. I can think of at least five different ways in which the CFOs will have to move.

First, too much preoccupation with short term results –the quarterly, half yearly and annual reports – has sacrificed the long term viability of many businesses. The demise of a number of well established companies such as Lehman Brothers, Arthur Andersen, Enron during the past few years is a clear testimony of the pernicious effect of this short term approach. Greed and monetary benefits for the management and shareholders have been driving forces behind this approach. CFOs have cut back on investment in critical technology acquisition or fired experienced talent in order to save costs. Little did they realize that this myopic outlook has weakened the capacity for efficient production in the future and impaired the competitive edge vis-à-vis others in the industry. Singular obsession with cost cutting is like harming the muscle in the process of reducing the fat in the body. The sooner the CFOs learn to distinguish critical investments for the future sustenance of the company from

avoidable waste and unproductive expenses the better off they will be in serving the company well.

Second, the exclusive emphasis on maximization of value for shareholders of the company has also proved to be hazardous. The CFOs will have to look at the prospects of maximizing the value of all stakeholders not only shareholders. Government, Suppliers, Employees, Customers, Communities all have interests in the production and distribution of goods and services and the value addition. The convergence of these stakeholders interests with those of the shareholders can create durable rather than transitory or peripheral benefits for the company. For example, sharing of value with the Government in form of taxes and duties, with the employees in form of fair wages and compensation, with the communities for supporting their social projects would win kudos for the company and ensure a smooth operating environment.

Third, the concept of single bottom line i.e. profit maximization has to give way to triple bottom line where financial and economic results are not the only indicator for measuring the performance of the company but the social impact and environmental impact are also given equal weight. Depleting non-renewable resources of a country at a rate that may produce large financial returns to the investors but leaves the society and the future generations worse off would no longer be considered as an acceptable performance measure. Similarly, if the company acts as an enclave of prosperity within a multitude of poverty, misery, illiteracy, disease and poor living conditions the results should not be taken as satisfactory. The recent trend of Corporate Social Responsibility that allocates a small fraction of profits to the community projects serves as a thin icing on the cake. The triple bottom line approach will involve some trade-offs in the short term but would prove to be a more robust and viable business model for an extended time horizon.

Fourth, the recent crisis has also revealed that the businesses that are not anchored in strong ethical values or do not practice good corporate governance are at much higher risk than they themselves realize. 'Walk the talk' as Americans say has become more crucial to success than 'Talk the talk' with all the right written scripts, verbose statements, pious intentions and ritualistic exhortations. It is only those Chief Executives who have practiced what they have preached, i.e. highest ethical standards and value-based management have come out ahead in this game. Those who were able to fend hundreds of million dollars as pay and perks or bonuses for themselves suddenly became object of ridicule and condemnation rather than admiration which they were used to. Enron had given rise to stringent laws and regulations with requirements of increase disclosure and oversight but the recent episodes have revealed the gap between the rhetoric and the reality. The CFOs have the responsibility to ensure that the company is observing and is in actual fact complying with the standards of corporate governance it has set for itself. Any violations should be reported to the CEO and if no action taken to the Board and still if no remedial action is taken to the regulators.

Finally, the CFO has to realize that finance is only a tool for strategy execution rather than a driver of business. The CFO has to play a key role in the formulation of the strategy and once the strategy has been agreed upon in the monitoring, follow-up and execution of the strategy. The financial plans have to flow from the Business Strategic Plan rather than the financial constraints coming in the way of strategy. This short sighted approach of CFOs does not serve the company well. For example, assume a company has to purchase a critical piece of equipment for seizing upon an opportunity offered by the market before the competition moves in when the finance disallows this purchase due to liquidity or cash flow considerations it is doing a great disservice to the company's future financial health by eroding its competitive edge. The responsibility of the CFO under these circumstances is to find the money for the purchase if he is convinced about its cost-benefit analysis. A narrow accountant perspective of

balancing the books is not what CFOs ought to be doing as it will put the company in dire straits.

To sum up, the challenges that the CFOs have to face in the context of emerging business environment are (a) how to move away from a short term to long term approach (b) how to strengthen stakeholder value rather than shareholder value only (c) how to measure performance based on triple bottom line rather than single bottom line (d) how to practice ethical values and corporate governance rather than paying lip service and (f) how to align finance with the achievement of the strategic objectives of the company.

I am confident that those of you who rise to meet these challenges have bright future ahead of you but others who continue on the path of status-quo would find themselves redundant sooner than later.