

FROM BIOLOGY
TO BUSINESS
AND BEYOND

THE SECRETS
TRADERS TELL

THE RISK, THE
WHOLE RISK
AND NOTHING
BUT THE RISK

BUSINESS AT oxford

THE MAGAZINE OF THE SAID BUSINESS SCHOOL
ISSUE EIGHT: WINTER 2005



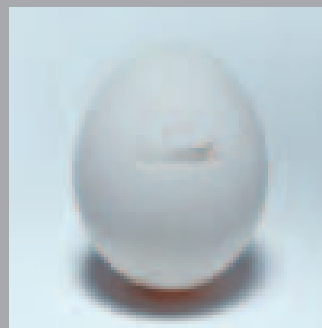
NEW MODELS



oxford
SAID BUSINESS SCHOOL

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Looking to the future

By Anthony Hopwood



I would like to open this issue of *Business at Oxford* by welcoming a major development in management education at Oxford University. The amalgamation of Oxford Executive Education, currently run by Templeton College, with the Said Business School (page 24) creates a firm platform on which we can build for the future. With this reorganisation, Said becomes a full-service business school, with a broad prospectus of executive and academic courses, while Templeton becomes a complementary

graduate college, bringing together an international community of high calibre students, faculty, eminent visiting scholars, business and other leaders.

At the Said Business School we are always looking to the future – whether it is our own future, the future of education, the future of business, or the future of the economy. That's why I am particularly delighted that this issue of *Business at Oxford* focuses on "new models".

New models are perhaps most in evidence in the School's research centres, which mirror the knowledge-intensive

end of the creative economy. In an article on page 10, David Cooper, a Visiting Professor with the School's Clifford Chance Centre for the Management of Professional Service Firms, considers what the regulation of accounting firms might look like as the role of international trading organisations changes, and multinational professional service firms become the norm.

Research on complex networks and agent-based models is being pursued within a recently-founded interdisciplinary research cluster called CABDyN (Complex Agent-Based Dynamic Networks – see www.sbs-xnet.sbs.ox.ac.uk/complexity/). Here, Felix Reed-Tsochas explains why CABDyN's work is important to business (page 4). Social networks are also important in the work that Han Ozsolyev describes on page 6.

Our students are helping organisations to look to the future too. The Strategic Consulting Projects carried out by teams of last year's MBA students were particularly successful with the examiners commenting on the excellent application of academic frameworks and teamwork, and sponsors praising the usefulness of the teams' recommendations. One such project, which looks to the future of biodiesel fuels in India is featured on page 9.

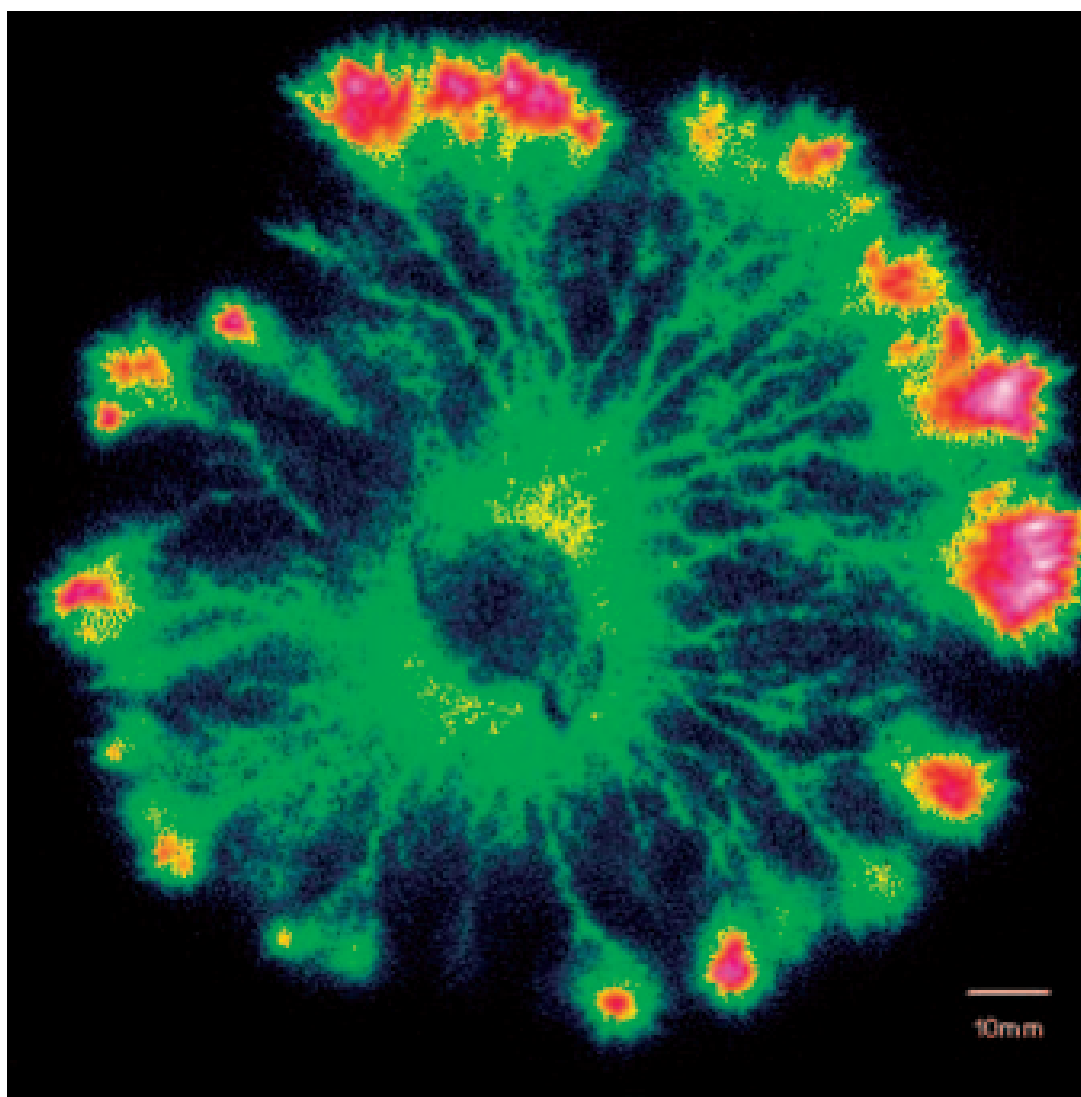
External speakers at the School contribute to our ongoing dialogue about the future: on page 26 Jim Goodnight and Art Cooke of SAS discuss the future of business intelligence; while on page 13 science entrepreneur Jerry Sanders gives advice on creating successful start-ups. A report on the first ever International Media and Communications Summit (page 14), held at the School earlier this year, considers convergence and divergence in the future of the media and technology industries.

My hope is that the forward-looking intellectual agenda of the Said Business School, in dialogue with other disciplines and with the practising community, will continue to bear fruit for years to come. ■



Anthony Hopwood

Image of nutrient transport in a fungus courtesy of M. Tlalka, S. C. Watkinson, P. R. Darrah and M. D. Fricker. Research supported by the BBSRC and NERC.



From biology to business and beyond

Felix Reed-Tsochas looks at the lessons to be learnt from woodland fungi.

Consider the following phenomena – the foraging trails generated by ant colonies seeking out food resources; the organisation and management of flexible supply chains in manufacturing and retail; the creation and transmission of innovative ideas and knowledge in high-tech industries; the

pattern of e-mail and phone traffic within organizations; the transmission of infectious diseases via social contacts; the congestion caused by introducing shortcuts in transportation networks; the correlations between the movements of different currencies in foreign exchange markets; the patterns in space and time which characterise terrorist incidents and attacks by insurgents.

What do they all have in common? One answer is that all of them are currently being studied at Oxford. But perhaps more interestingly, it has also been discovered that all of them can be understood and modelled if we think of them as dynamically evolving network structures – that is to say, as distributed systems without any centralised control.

Of course, the constituents and the properties of these systems differ radically. No-one would suggest that they can all be accounted for by one master theory or universal model. However, in each case we can gain unique and novel insights into the behaviour of the system by modelling it in terms of so-called ‘agents’ which are linked to each other via a complex and evolving network structure.

The agents in our models may represent individual ants in a colony; traders in financial markets; inventors contributing to a technology domain through patents and other publications; organisations and firms which are connected to each other in a supply chain; or different units within terrorist or insurgent groups. Agents representing different entities will clearly need to be assigned different properties: whereas in some cases it may be appropriate to assume that agents follow fixed simple rules of thumb, in other cases we may wish to allow agents to engage in purposeful decision-making and give them the ability to learn from past mistakes.

However, following the approach adopted in most agent-based models of complex systems, it is important that we do not assume that the agents in our models are perfectly rational decision-makers or calculating machines with complete information about the system or network which they inhabit. Agents may be able to foresee some limited consequences of their own actions, but they cannot predict how the aggregate of their collective actions will affect the evolution of the overall system.

The emergent properties of such systems cannot be trivially reduced to the properties or behaviour of the constituent parts. The individual properties of all the constituent agents within a system are not sufficient on their own to characterise and

model the system. Agents will interact with other agents through mechanisms such as the exchange of resources and information or by establishing a link of trust or reciprocity, and the local and global features of the resulting pattern of interactions often have a very significant impact on the overall system behaviour. If we envisage agents as sitting at the nodes of a large network structure, then the links between these nodes correspond to the flow of different types of resources and information, or represent some kind of established relationship.

As examples of such links, we can think of the flow of materials within a supplier network; the transmission of viruses between individuals; the flow of capital between venture capital firms and the firms they invest in; the joint membership of a company board; or the co-authorship of a patent. In modelling such systems, we must allow for the fact that agents may not only regulate the resources flowing through them, but can also break existing links and create new ones.

Clearly, models involving a heterogeneous population of agents linked through a complex and changing network structure are highly nonlinear, and are very difficult and challenging to analyse. But rapid advances in this field of study are currently being made, by bringing in different tools from statistical physics, mathematical biology, analytic sociology, and computer science. These ingredients, when mixed in the right way, may give us a powerful new lens through which to view and understand such systems.

In Oxford, the research on complex networks and agent-based models described above is being pursued within a recently founded interdisciplinary research cluster called CABDyN (Complex Agent-Based Dynamic Networks – see <http://sbs-xnet.sbs.ox.ac.uk/complexity/>). Because CABDyN aims to develop network models that can be applied across a wide range of disciplines and application domains, it is crucial that more than ten departments within Oxford are currently active participants. The Saïd Business School has played an important role from the start, hosting CABDyN’s first international conference in October 2003 and many of CABDyN’s research workshops and seminars.

The recently launched MCOMNET Project (Measuring and Modelling Complex Systems across Domains), which is funded under the European Commission’s New and Emerging Science and Technology Programme, is also led from the Saïd Business School. The project



Felix Reed-Tsochas is a Senior Research Fellow in Complex Systems at the Saïd Business School and one of three Co-Directors of the CABDyN research cluster.

involves seven University Departments in Oxford and five other European partners in France, Germany, Switzerland, Poland, and Sweden.

The work of CABDyN has attracted considerable interest in the media, and recent pre-prints that have received wide press coverage range from a network model of voting behaviour in the Eurovision Song Contest to a model of the intensity of civilian casualties in the armed conflicts in Iraq and Colombia. In order to give a clearer picture of this kind of research, let me give one more detailed example of our ongoing research.

Mark Fricker and his colleagues at the Department of Plant Sciences have over a number of years conducted extensive laboratory experiments to collect data on the evolving network structure and the patterns of nutrient transport in foraging saprotrophic woodland fungi. These fungi cover large areas of the forest floor, and are known to scavenge efficiently for scarce resources in a varied and changeable environment, and to adjust their network architecture effectively to environmental cues such as damage or predation. Of course, the fungus is able to adapt its structure and to redistribute nutrients in a well-coordinated manner without the need for any centralised form of control or intelligence, and so the network structure reflects the outcome of a process of biological self-organisation which has been honed by evolution. Neil Johnson and his students in the Department of Physics are currently developing a range of agent-based models to try to account for the structural evolution of these fungal networks, in order to see whether the observed growth patterns can be replicated in computer simulations starting with very simple rules for agents in agent-based models. However, the larger research agenda goes well beyond the attempt to replicate the observed behaviour of a particular biological system in a computer model. We know that woodland fungi are highly adaptive and resilient, and represent a real-world compromise between fragile efficiency and costly robustness. If agent-based models enable us to understand the mechanisms and processes that allow such structures to grow and evolve, then we can perhaps abstract some more general principles for self-organised design and bring them to bear in very different application domains.

Might the lowly fungus give us some clues on how to make supply chains or transportation networks, for example, less vulnerable and more flexible and adaptable? ■

There is extensive evidence showing that traders frequently communicate with each other in financial markets. Precisely speaking, traders voluntarily exchange information on the assets that they trade. A survey by Shiller and Pound in 1989 demonstrated this: the authors surveyed 131 institutional investors from the US and asked them what prompted their most recent stock purchase or sale. The majority asserted that it was their discussions with their peers.

Why should we be interested in this commonly observed phenomenon? Because communication among traders plays an important role in financial decision-making and asset pricing.

However, it is not just communication that affects financial decisions. The social network, according to which communication takes place, is also highly relevant. For instance, a recent empirical study by Hong, Kubik and Stein shows that mutual-fund managers are heavily influenced by

the decisions of other fund managers working in the same city: a fund manager is more likely to hold or buy or sell a particular stock in any quarter if other managers from different fund families located in the same city are holding or buying or selling that same stock. The authors interpret this as an outcome of word-of-mouth communication across fund managers.

In a different study, the same authors also argue that stock market participation is influenced by social interaction: they conclude that “social investors” find markets more attractive when more of their peers participate.

Motivated by the empirical evidence, I decided to investigate this issue. I wanted to create a theoretical framework for communication in social networks so that we can analyse its financial consequences. So, I proposed a financial market model in which traders initially have imperfect and diverse information about the asset pay-offs. I assume that, via communication,

traders gain information about the asset payoff structure from others in the economy and also share their own information with others. The social network indicates whom each agent learns from and shares information with. The social network can be considered to represent geographical proximities as well as social relationships, such as friendships and acquaintanceships. I model social networks by graphs: vertices of the graph represent traders and the links between the vertices represent social links or communication channels. Once traders utilise their social links to communicate information, they trade on the assets.

The proposed financial market model allows us to tackle head on the problem of financial implications of communication in social networks. The first thing we learn from this model is that “social influence” affects asset pricing. That is, traders with higher number of social links have higher impacts on asset prices. This is because socially influential traders get to communicate with higher number of people; hence price movements mostly reflect their information. Moreover, the model suggests that traders from the same “tight-knit social cluster” would have

higher asset demand correlations compared to those from different social clusters. The last finding from our model seems to be consistent with Hong, Kubik and Stein’s empirical work on mutual fund managers’ holdings, if we categorise “being in the same city” as “being in the same tight-knit social cluster”.

The proposed model also offers a candidate resolution to a well-known asset pricing puzzle: “excess price volatility”. Excess price volatility refers to the empirical observation that stock prices are more volatile compared to stock fundamentals. In our stylised model, we can consider the stock fundamental to be the stock payoff. The model justifies excess price volatility when the social network is highly centralised so that most traders learn from common sources.

There is one important caveat in our model though. The model assumes that communication takes place among socially proximate traders but it does not justify or try to explain why they would communicate in the first place. After all, by sharing information, traders lose their monopoly on their private information. However, traders also benefit from communication as they can better assess future risks with their increased information. It is unclear where this tradeoff leads us. So that leaves us with the following questions: Can we come up with a model in which information sharing makes traders better off? Can we sustain information sharing as the optimal choice for traders?

Nevzat Eren, from the University of Minnesota, and I decided to seek the answers to these questions. In our stylised model, we showed that traders can indeed be better off by sharing information. This happens when the market is opaque so that informed and uninformed trades are difficult to distinguish. Also, traders need to be risk averse for information exchange to imply welfare improvement for them.

However, the fact that information exchange can improve welfare is not sufficient guarantee for informed traders to exchange their information when they act strategically. There are many economic environments in which individual rationality and social rationality conflict. In our case, each informed trader may actually choose not to share any of her information, fearing that others will cheat and hoard their information while she discloses hers. The sociological literature demonstrates that in numerous circumstances individuals hoard information while it is in the collective interest to communicate. Bonacich calls this phenomenon a “communication



Han Ozsolyev

dilemma”. Our financial market model also yields a communication dilemma. That is, there are circumstances in which informed traders actually choose not to communicate their information even though it is beneficial for them to do so.

In light of the extensive evidence on the existence of frequent communication in financial markets, the last result is rather discouraging. We offer a resolution to this dilemma by introducing interpersonal (or sociological) costs. In particular, we argue that the cost of hoarding information while others disclose cannot be just based on asset trading. If the information exchange takes place among socially proximate traders, such as peers, colleagues and friends, there is also an interpersonal cost for “cheating” on others. When we introduce such social cost to our model, we indeed demonstrate that traders optimally choose to communicate their information if the “interpersonal cost of cheating” is sufficiently high.

What we offer as a resolution to the dilemma, is also consistent with the recent empirical and experimental studies. These studies implicate that communication mostly takes place among socially proximate agents in financial markets. As the “interpersonal cost of cheating” would presumably be higher among socially proximate traders, communication is more likely among such traders in our model as well.

The work described here is just a step toward an understanding of the role of communication in the functioning of financial markets. In the future, Nevzat Eren and I hope to examine in greater detail the incentives for communication and its consequences for financial markets. ■

Han Ozsolyev observes the way traders communicate with each other in financial markets.

The secrets traders tell...



Stephan Bisse MBA 2002



How to profit from the noise of the rabble

A new website hopes to prove that crowds of random individuals are better stock-market forecasters than the experts, says Guy Dennis.

Stephan Bisse, 40, a former City trader at Goldman Sachs, who completed his MBA at the Saïd Business School in 2003, has set up ConsensusView.com, helped by two computer science graduates from Worcester College, Ed Smith and Sam Brightman.

Each day, members of the public are invited to vote on whether they think any one of a series of share prices, indexes,

currencies and financial futures contracts will rise or fall that day. Voters do not specify an actual forecast; they simply predict a rise or fall, and have to do so between 4.30am in the UK and the opening of the market they are voting on. There is the lure of \$1,000 (£550) for the best forecaster each month.

The Oxford three hope to test the theory that crowds have wisdom, and if it holds water, create a business out of it.

Bisse already runs a business importing and selling trading-system software, but believes that the website will also offer commercial opportunities if it gains momentum.

One idea is to put links on the website allowing voters to click through to online services offered by stockbrokers, who would pay a commission for business introductions. The three graduates also plan to offer subscriptions to services that scrutinise voting data to help find deeper predictive trends.

The key to all these efforts, however, will be the site's ability to attract voters and, ultimately, to forecast accurately the direction of markets. Two weeks after its launch, just 52 people were voting on it, but with a larger number the theory that a consensus view will tend to be right will be tested more comprehensively. If the theory proves correct, the website's forecasting would become valuable and draw more visitors, some of whom would then presumably vote, further boosting the service.

"With a website like this, it is chicken and egg," says Bisse. At the moment, voters on the site include staff at ABN Amro and Goldman Sachs, the investment banks. Hedge fund traders are also among voters, although he will not disclose which funds they work for.

So how are the voters doing? Bisse and his colleagues measure performance by looking at the percentage of times the voters call the market direction correctly. If they get it right only half the time, this is no better than randomly guessing the market's direction. But anything more than 50 per cent over a sufficiently long period suggests that the voters do have predictive ability.

"We are encouraged so far," says Bisse in his Germanic accent, sitting in a small business park office. Performances since the start of September, when the site started taking votes, vary between markets. But voters have called the daily direction of the FTSE100 index correctly 57 per cent of the time so far. For the gilts market the figure is 54 per cent, and for US 10-year bond futures the figure is 55 per cent, for example.

"At the moment, it's not that significant, but when the number of participants reaches around the 1,000 mark, it could become very, very interesting," Bisse says. Ultimately, he hopes to draw tens of thousands of voters to the site from across the world. ■

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Future fuels



We chose to carry out our New Business Development and Strategic Consulting Projects in the field of biodiesel. Biodiesel is a clean-burning alternative fuel that can be made from renewable materials such as vegetable oils, animal fats, and spent cooking greases. We became interested in the product because of its potential for delivering a greener environment and because it provides a means of social empowerment in rural areas.

India seemed to be the perfect market to focus on for social, economic and environmental reasons: rural poverty is high, many of India's cities suffer from high pollution levels, and 70% of India's oil is currently being imported. We explored many of the basic issues as part of our New Business Development Project, but to carry our ideas forward and actually start a business in this sector, we needed to test the ground level realities.

The Strategic Consulting Project provided the perfect opportunity to do this.

Specifically we decided to evaluate the feasibility of producing biodiesel in India. As part of our feasibility study, we consulted a range of stakeholders and experts in this emerging field, including: state and central government representatives, private and academic research institutes, non-governmental organisations, small-scale farmers, social entrepreneurs, and companies operating in the biodiesel and oil sectors. Most of our work was carried out on the ground in India. We travelled to the states of Uttaranchal, Orissa, and Chhattisgarh and Karnataka, using Delhi as our base. We also got great support for our research from an alumnus, Sagun Saxena, who also has active interest in renewable energy.

We spent the first week of the project analysing the worldwide biodiesel market and researching the companies operating in this area. For the following three weeks,

Project
Biodiesel

Sponsor
Roland Berger

Team Members
Alex Valassopoulos
David Brooks
Shashank Verma
Sujeet Kumar



we focused on field research and stakeholder consultations. We received extensive training on all aspects of biodiesel, visited plantations of *Jatropha Curcas* (one the plants from which biodiesel can be made) and witnessed the transesterification process by which *Jatropha* oil is converted to biodiesel. After the field research stage, we consolidated the data and reviewed our key findings with our project sponsor, Roland Berger Strategy Consultants. Finally, we wrote up and presented our report.

The project had its ups and downs. Navigating through government bureaucracy (like navigating through rural Indian roads) can be quite challenging! However when we met with the Planning Commission of India – a key policy advisory body of the central government – we were thoroughly impressed by their hospitality and professionalism. The Planning Commission put us up for four days and arranged a power-packed agenda of briefings and meetings. The way they rolled out the red carpet for us made us appreciate the power of the Oxford brand. After completing our field research, we re-visited the Planning Commission to brief them on new developments we had observed and to share our findings. This gave them a chance to get feedback from a neutral perspective, which they really appreciated.

The project had many highlights, including riding in biodiesel-powered vehicles, observing landless labourers planting *Jatropha* on degraded Himalayan hillsides allocated to them by authorities, and making biodiesel for ourselves in a lab at Delhi College of Engineering. These experiences made us realise the potential for biodiesel to change the face of the oil industry in India. Some of us are now taking our idea forward and starting an entrepreneurial venture in this field. ■

My colleague, Roy Suddaby, and I are embarking on a research project to explore the global regulation of accounting labour as it evolves.

Currently, the regulation of accounting labour revolves around the nation state and professional associations. As you might expect, there are restrictions on British accountants working in Canada, and on Canadian lawyers practising in Britain. In Britain, the state delegates the definition of what is an accountant or a lawyer to professional bodies such as the Law Society or the Institute of Chartered Accountants in England and Wales. In other EU countries, the state may directly determine whether or not you are a lawyer or an accountant.

Whatever the agreement at national level, it is now being challenged by two developments: the first is the development of international trade organisations; the second is the growth of multinational professional service firms.

The World Trade Organization is pushing for greater free trade in services. This has huge implications for large international professional service firms, and also for professionals themselves. The WTO is saying that many of the existing protections can be seen as restrictions on trade, and suggesting it should be for the consumer to decide whether a practitioner's knowledge of law or accountancy is sufficient for their purposes.

This shift towards the global regulation of professional services does not mean that the professional associations or the nation state will become irrelevant. It means that they are likely to take different types of roles. Whether these entities are more or less powerful in the new regime is unknown, but it seems likely at least that professional associations and nation states will have different relationships with the professionals in their country in future.

What Roy Suddaby and I are particularly interested in is how the new global regulations will take shape. What specific form

will they take? Who are the players in the new regulatory game? Who has the most influence? And how will this affect the outcome of negotiations?

The main aim of our project is to identify the new issues and delineate new roles for different players. For example, what will be the new role of a professional association? Will it be a professional club? A dining society? A trade union? A spokesperson for the large firms? Or a police force patrolling its members? What role will multinational firms play? Will they, as we suspect they might, take on a major role in these negotiations? Will they stand in for nation states? Does this then have public policy implications with regard to accountability and issues of democratic control? What will the accountability processes be? And what sort of freedoms will nation states have to control what goes on within their territory?

I have been interested in issues of accountability for a long time, particularly in the accounting profession. One of the great ironies in this area, it has always struck me, is that accountants talk about accountability all the time, but are not very accountable themselves. For all sorts of very legitimate reasons, the large

accounting firms do not have to publish any audited financial information. They do not produce financial information like other corporations, their governance structures are private, and yet the "big four" firms are bigger than many household names, such as Coca-Cola. Most accountants would say, "We are accountable. We are accountable in the marketplace." But the accountability they promote for others is not the same kind of accountability they want applied to themselves.

I guess you could call me a naive democrat. I think there should be more democracy in organisations, and particularly in the professions. There should be more accountability, more reporting, more attention paid to the governance of professional associations and professional firms. I also think these organisations should be run more like the partnerships they purport to be. They are partnerships in legal form, but their practices are largely corporate, and they are often more bureaucratic and more hierarchical than private sector organisations. They are constructed in the mould of an old-style public corporation, or Whitehall bureaucracy.

The recent wave of corporate scandals

is not a new thing. Corporate scandals crop up at regular intervals, and the question is always, "Where were the auditors?" Recently, the auditors seemed to be in there with the fraudsters, which did create some drama, but the whole history of accounting is a cycle of scandal, demands for reform, and resistance on the part of accountants. Accountants have always been adept at managing public relations and have been able to resist large numbers of attempted reforms. Enron and WorldCom are obvious examples of major recent scandals, but similar examples can be found in the 60s, the 30s, at the turn of the twentieth century, and before. I see myself as part of an ongoing voice demanding that professionals should be more accountable.

A lot of the work that has been done so far in accounting on internationalisation has been about harmonisation of rules across different national bodies and nation states. My own suspicion, and I think there is evidence to support this, is that even within some fairly tight rules, a great deal of discretion is available. There is such an enormous range of latitude about how a particular transaction is accounted for. So what interests me is how individual auditors and their clients negotiate; how they arrive at a position where they say, "We will handle this transaction in this way, and we will represent it like this in the books."

As a researcher, what I need to do is to go inside a firm and see how these negotiations take place. I have tried for over 20 years to get access to study this subject specifically and my success, unsurprisingly, has been virtually zero. Firms say in effect; "You're the fellow that wants more democracy in the profession? Well thanks, don't call us; we'll call you!" But at the same time, these firms are saying, "We wish accountants did research that was more relevant to us, more realistic, that related to our experiences!" Accounting firms want research as long as it doesn't open the black box of what goes on between the professional and their client.

Of course not all professionals feel this way. When I speak with senior people in professional bodies or professional firms, they are very interested in the questions I am asking. They see major challenges ahead and want some open discussion about them. People who are not involved with thinking strategically about their organisations tend to be more defensive. Being open to research does impose some risks on the firms and professional bodies, but sometimes you have to realise that your best friends say things you would prefer not to hear. ■

David Cooper is CGA Professor of Accountancy at the University of Alberta, Canada, and Visiting Professor at the Clifford Chance Centre for the Management of Professional Service Firms, Saïd Business School.

Free trade in services

David Cooper talks about his research into the global regulation of accounting labour.





Profile

Eric Thun

Eric Thun's book *Changing Lanes in China: Foreign Direct Investment, Local Governments and Auto Sector Development* will be published by Cambridge University Press in December 2005.

“If you could put an inch on the hem of every Chinese man's shirt,” says a classic proverb of foreign businessmen interested in doing business in China, “you would be a rich man”. With a population of 1.3 billion, the attractions of the Chinese market are clear. Yet the recent “bra wars” together with the high profile failure of several joint ventures attest to the difficulties that China and the west are having in coming to terms with one another.

So can the country's economic potential be realised? And how can China and the west negotiate the transition? Eric Thun, the new Peter Moores University Lecturer in Chinese Business Studies at the Saïd Business School, has a more informed view than most of the possibili-

ties and perils of doing business in China.

Thun, who speaks Mandarin Chinese, joins the Saïd Business School from Princeton where he was attached to the politics faculty. “The work I was doing on Chinese firms could loosely be classed as political science, because almost everything in China involves the state and politics, but it was explicitly focused on the development of Chinese firms and I thought I would benefit from being around people who think about firms,” Thun says, explaining his shift into business studies.

Thun's forthcoming book on the Chinese auto sector reflects this cross-over between politics and business. Entitled “*Changing Lanes in China: Foreign Direct Investment, Local Governments and Auto Sector Develop-*

ment”, it looks at how local governments in China use joint venture projects with foreign companies to promote local development. Based mainly on interviews with factory owners and local policy-makers, it demonstrates the importance of local governments and business groups in shaping the development approach of different regions of China. On the ground, it seems, the central government in Beijing has little control and is having real difficulty implementing a coherent industrial policy.

So how can companies negotiate a path through this political minefield? The answer, according to Thun, is in-depth local knowledge—really understanding how the system works and having good, local people working for you.

But navigating the local bureaucracy (and the associated corruption) is just one of the many challenges businesses face. One of the commonest difficulties lies in protecting intellectual property. “It's all too common,” Thun says, “to set up your factory, only to find six months later that a new factory down the street is making the exact same product with a different name.” Then there's the danger of overestimating domestic demand and underestimating the strength of local competition. “Coming in and assuming that what you sell will do well in China because it's been successful elsewhere, time and again hasn't worked. Local companies are very flexible and quick to adapt and beat out the western companies.”

So does the future really belong to China? “In many respects,” Thun says, “the press reports that you read about China overlook many of the problems that exist in the current system, including the weak financial system, the massive environmental problems, the growing inequalities, and the potential for conflict with its neighbours.”

Despite all this, Thun believes that in the longer term, both the west and China should be able to benefit from China opening up. “While there are bound to be shocks as China is brought into the global economy,” he says, “China will probably stay on track. There is this fantastic combination of high quality human capital, good infrastructure and low cost labour. China has surprised people in the past with its success, and it will probably keep doing so in future”. Thun's own future remains firmly bound to China, and he will be extending his research to cover China's integration into the WTO and to look at other industries, including the electronics sector. ■

Serial Entrepreneurship

Science entrepreneur Jerry Sanders explains what it takes to create a successful start-up.

Most students want to know if entrepreneurs are born or made. My view is that everyone can be brought to a certain base level, but not everyone is going to be a star. It comes down to people's willingness to do certain things. Take networking, for example. Networking is not something entrepreneurs do because they enjoy it; it is a task. Most people can do it if they decide it's worth the emotional energy, but there are some people who are going to decide it's just not worth it to them.

What I like about the start-up phases of businesses is the multi-tasking that is required. Start-up companies are mostly about solving problems and solving them quickly and economically. It's not just a case of finding any solution—you have to find the best solution—one that is economical, viable, complies with the regulatory environment you operate in, and keeps shareholders satisfied. It's like a complex puzzle. To me, this process is very exciting, but it's also very stressful.

Another of the traits of an entrepreneur has to be the capability of dealing with a lot of stress. I compare it to those punching dolls—you knock the doll down and it rights itself; you knock it down again and it rights itself again. You have to wake up every morning knowing you are going to get clobbered over the head with a two by four, go there knowing it's going to happen, and then wake up the next morning and do it all over again. There's no doubt that you need a thick skin.

Entrepreneurs are good at telling stories. We tell fairy tales about what can be, and we try to get our audience to be part of the fairy tale. But it's not just a rhetorical trick. You have to have enough real ammunition, so that if someone in the audience suspects you are shooting blanks, you surprise them with some live bullets!

Science entrepreneurs operate in a very tight regulatory environment. Our barriers to entry are higher than for other kinds of start-up companies. We not only have to come up with a good idea and patent the idea, make the product and put

it in the marketplace, we also have to pass muster with the regulatory agencies, wherever they may be. Those barriers can be very costly. In fact, they can sometimes be so difficult to hurdle that they can kill the company.

For example, we had a company that dealt with stroke therapy. Our technology was extraordinary. What it did was it reversed the blood flow in the brain. Instead of the arterial blood going up to nourish the brain, we got the arterial blood to flow down and go through a blood filter into the vein, pulling with it the blood clot that was causing the stroke. We went to the FDA

and demonstrated that the technology had been tested on humans under strict clinical protocols and worked, but the panel told us that what we were describing was impossible. In the end, we did persuade them, but it took a very long time.

I believe that personal liberty follows economic liberty and that it is very difficult to have one without the other. If we have lots of folks out there incentivised to take a risk, then the likelihood of having lots of little motors of wealth creation is tremendous. That's how we get prosperity, whether it is in Silicon Valley, Bangalore or Beijing. ■

Jerry Sanders is a serial entrepreneur. He teaches a seminar at the Saïd Business School called “Something from Nothing”, which shows students how entrepreneurship works in practice.





International Media and Communications Summit

Mark Getty discusses convergence and divergence in the world of technology and media.

The unavoidable consequence of the mountain of information now available to all of us through various mediums is that plagiarism has become inevitable. Nothing I say here is likely to be in any way original. This is the first and most obvious sign of convergence. We all say and think the same things.

The internet was supposed to be the great disintermediator. So name ten industries that were disintermediated by it. Name five. It's not easy. I can come up with many examples of industries which have been transformed by the

web – including my own – but not many where the basic structure of the industry has changed.

One good example is open-source software. However, Linux and Apache have yet to replace commercial web-server software and applications. Another example is peer-to-peer file sharing companies like Napster and Gnutella. They did get rid of the middle man – in this case the record labels – but they got rid of revenue and profit for the producers as well and are now in the process of being replaced by the likes of record labels plus Apple, Yahoo and Real Networks.

Interestingly, in some cases, the advent of the internet has actually created intermediation where it did not exist before. Surely the internet was about getting rid of middle men? What about eBay then? The activities which now occur on eBay originally occurred in garage sales, car boot sales and church socials without an intermediary. eBay now stands in the middle. What was a previously disaggregated disintermediated global activity is now aggregated and intermediated.

Part of the youthful enthusiasm surrounding the internet is to always see it as revolutionary. Search engines were going to replace almost all known media because all media is digitisable, and therefore search, selection and distribution could all happen on-line and bingo! You have Yahoo!. You don't need Time Warner or News International or, in our case, Getty Images.

What if Yahoo! or Google actually start manufacturing things?! We might only need one company worldwide! It would certainly make investing easier. Convergence means lots of things. What it does not mean, however, is that great companies with great products and great values are going to disappear in a kind of technological apocalypse.

So that's it. A simple story. Conclusion: convergence means lower costs and greater profitability. Well yes, and no. Like all simple things in life, it is actually much more complicated than that.

On the face of it, the internet has created a level playing field and eliminated some traditional barriers to entry in a wide range of industries. This leads to a slightly counter-intuitive conclusion which is that the internet is the key medium to date in the convergence story and is both an anarchic medium favouring diseconomies of scale and, at the same time, is an environment which favours aggregators.

So, if, in theory, the internet has flattened the competitive environment, lowered distribution costs and lowered

barriers for entry, why would anyone argue that it is an environment for aggregators?

The simplest answer is that it is a victim of its own success. The internet is at one and the same time an interactive distribution and information medium. It knows that you know, and you know that it knows. It is direct marketing and real time product development on steroids.

What convergence of media on to portable and interactive platforms allows us to do is to radically transform the landscape of product marketing – to replace art with something closer to science.

Real time, localised and subject specific knowledge of consumers' desires and behaviour will dramatically increase the effectiveness of advertising and marketing with the related enormous benefit of bringing down the cost of product development and inventory. Everyone benefits and hopefully they will all need a picture.

Predicting the future is a bitter sweet sort of dish. On the one hand, I cannot be wrong today and, on the other hand, I will be completely and utterly wrong some day soon.

My predictions are: firstly, the mobile revolution will overtake the computing and internet revolutions in both commercial scale and behaviour; secondly, the role of virtual businesses will greatly expand.

I will end with a hope rather than a certainty. That is that government will catch up with the changing environment faster than it seems to. The organisation of political power always lags behind industrial and economic development, leading either to lost economy and, if not lost opportunity, then political obscurantism leads to far worse.

Today, our political institutions have yet to recognise that globalisation is challenging the nature and focus of political authority. My hope is that immigration policies, industrial and monopolies and mergers policies, education policies and fiscal policies stop being seen through the narrow prism of the nation state but rather through the much broader, energetic, highly competitive panorama of a globalised world. ■

Mark Getty is Co-founder and Chairman of Getty Images.





David Bonderman, Sir Victor Blank, and Philip Green take audience questions.

Saïd's number is up! Despite a downturn in the MBA market which has hit some business schools badly, the number of full-time MBA students joining the Saïd programme is up. 227 students have joined the programme, an increase of 60 on last year's class. The international diversity increased also, with students coming from 48 countries.

Masters in Financial Economics course kicks off. In October the inaugural Masters in Financial Economics programme started with 72 students from 24 countries. The nine-month course has been designed in consultation with leading financial institutions, and will match the exacting demands of top recruiters.

Programme Director and former investment banker **Howard Jones**, comments: "This is a completely innovative and exciting course. While it is academically rigorous, as you would expect from Oxford, it is also applied and closely matches the needs of the financial community. A mastery of finance theory and an ability to apply it are mutually dependent. We will equip the students with the theoretical base and practical skills they need to hit the ground running at the highest levels in the financial world."

New Diploma offered with ICAEW. The Saïd Business School and the ICAEW have announced a new programme for accountancy professionals. The year-long, module-based diploma course will begin in January 2006 and offers a new opportunity for chartered accountants to develop their skills and experiences whilst at the same time gaining a prestigious Oxford qualification. Drawing on Oxford's strengths, particularly in finance and strategy, the new Diploma offers a distinct intellectual edge combining the highest standards of academic rigor with a practical understanding of business and wealth creation.

New Taxation Centre announced. A unique research centre focusing on taxation policies and policy options affecting business in the UK was launched at the Saïd Business School in November as the result of co-operation between The Hundred Group, representing the largest listed UK companies, and the School. Members of The Hundred Group have committed substantial funding to the Centre for an initial five-year period.

The Oxford Business Taxation Research Centre will carry out a programme of multi-disciplinary research drawing

together the expertise within the University in the fields of economics, law and politics. It will examine the approach to the taxation of business activities in the UK and evaluate the effects of the present structure of taxation on the business sector, the public finances, international competitiveness and the wider economy. The Centre will also address policy options that take account of the international dimension to business activity, the interaction between different tax systems and the global influences on policy formulation.

Oxford Institute of Retail Management to join the School.

As part of the new arrangements for management studies in Oxford, the Oxford Institute of Retail Management directed by **Jonathan Reynolds** will be joining the Business School as one of the School's research centres. The Oxford Institute of Retail Management (OXIRM) was established within Templeton College in 1985, to relate sound scholarship to the practical needs of retail and consumer service companies. In this bridging role, OXIRM has had an active applied research programme, a series of revenue-generating research workshops, engages in active networking through its Oxford Retail Futures

Group, and publishes the European Retail Digest. The move recognises retailing as an integral part of the mix in developing a new approach by Oxford to the study of marketing and consumption.

First Executive MBA students graduate from Saïd. On Saturday 10 September, the first cohort of Executive MBA participants graduated from Saïd Business School after a demanding 21-month programme. 28 participants from 11 countries made up the first Executive MBA (EMBA) class, coming from a wide range of sectors including automotive, construction, newspaper distribution, consulting, polymer chemicals, technology transfer and mining.

On completing the course **Adrian Black**, one of the graduating EMBA students commented: "I can now appreciate how our preconceptions have been challenged and how our minds have been stretched. Our ability to approach, define and solve a wide range of problems has been significantly enhanced. We are also more aware not only of our strengths but of our weaknesses. We have been equipped with a problem solving toolkit and understand more about the questions we should ask before leaping into a

Business as usual

Saïd Business School welcomes...



Eric Thun Peter Moores University Lecturer in Chinese Business Studies.

Brief biography: Prior to coming to Saïd Business School, Thun was Assistant Professor of Politics and International Affairs at Princeton University. His research focuses on issues of industrial development in China, and his book *Changing Lanes in China: Foreign Direct Investment, Local Governments and Auto Sector Development* will be published by Cambridge University Press in December 2005.

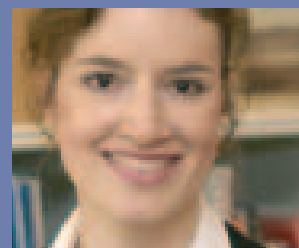
Greatest achievements: Successfully conducting years of field research in China without being forced to sing karaoke.

Thinking about: My current projects all revolve around the emerging form and strategies of Chinese firms. How do they acquire technical capabilities? Why and when do they invest overseas? How do they survive and prosper at home?

Hopes to achieve: The speed of development in China makes it an incredibly dynamic business environment, but also makes it difficult to stay on top of what is happening. I would like to see Oxford become a centre for the study of business in China. The University already has a strong tradition in China studies. There is also a strong network of Saïd Business School alumni in

China. The School must capitalise upon these resources to stay at the fore of what will be one of the most important business stories of the next century.

Other passions: Travel and skiing – looking forward to exploring the Alps!



Celine Rochon University Lecturer in Finance, Fellow of Oriol College.

Brief biography: Celine Rochon was University Lecturer in Economics and Director of Studies at the University of

Cergy-Pontoise, France, prior to joining the Saïd Business School. Of Canadian origin, she did both a BSc and a MSc in Mathematics at the University of Ottawa. She then did a PhD in Economics at CORE (Centre for Operations Research and Econometrics), Université Catholique de Louvain, Belgium. She participated in numerous international conferences over the last years and was a visiting scholar at the IMF Institute in Washington last summer.

Greatest achievements: "The passing day is prey to error. Time commands success and achievement." (Goethe)

Thinking about: Part of my recent research has focussed on theoretical aspects of currency crises, namely the strategies of speculators in an environment without common knowledge. Next step: investigate the monetary and fiscal mechanisms as

well as financial structures in place or to be designed in East Asian countries, and in particular China.

Hopes to achieve: The ultimate goal: make a difference!

Other passions: Travel, classical music.



Eamonn Molloy University Lecturer in Operations Management, Fellow of Green College.

Brief biography: Eamonn previously worked at the University of Warwick and the University of Bath since completing his PhD in Science and Technology Studies at Lancaster University.

Eamonn's research focuses on interactions between work, technology and organisation, particularly in the context of organisational change. The research has covered a range of sectors including oil, minerals, energy, nuclear and healthcare. Eamonn's work is distinguished by a close collaborative relationship with the organisations he works with.

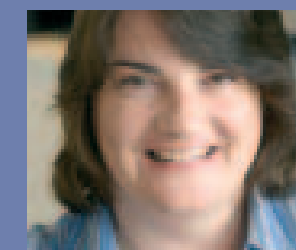
Greatest achievements: ■ Demonstrated the applied value of interdisciplinary academic work to practical organisational issues. ■ Worked as a member of Kendal Mountain Rescue Team for seven years. ■ Qualified as a pilot – and barrel-rolled a Nanchang (deliberately!)

Thinking about: ■ The transformation of health-care settings as a result of new information and communication

technologies (ICTs). ■ How successful project management practices relate to different product and service strategies. ■ Building research programmes around technology based organizations and service organizations. ■ Executive Education and MBA teaching in strategic project management.

Hopes to achieve: A better understanding of the relationships between human activity, organisation and technology.

Other passions: Flying, Mountaineering, Snowboarding, Skiing, Reggae Music, Los Angeles.



Fiona Anderson-Gough University Lecturer in Accounting, Fellow of Templeton College

Brief biography: Fiona joined the Saïd Business School from the University of Leicester where she was a Senior Lecturer in Critical Accounting and Management. Prior to this she was a Lecturer in Accounting at Warwick Business School and had undertaken a number of academic research posts at the University of Leeds, UMIST and the University of Wales Swansea prior to that. She began her career in 1990 as a Research Analyst in a consultancy business which was

problem... The diversity and experience of the class was richer than I expected; the standard of lecturing was higher than I expected and I have gained far more insight and knowledge than I ever expected."

The University of Canterbury has launched an awards programme, the **Keith Blois' Internship Prizes**, in recognition of the contributions Dr Blois made during his time as a University of Canterbury Visiting Oxford Fellow in the University's College of Business. They will be awarded for the four most outstanding student projects in the College's Marketing Internship Programme in four sector categories: manufacturing, retail, non-profit, and public.

What does Buffy the Vampire Slayer have in common with Charles Babbage? This connection is made by Kate Blackmon in a forthcoming book combining strategic and organisational perspectives with operations management. Blackmon argues that the core management discipline of operations management, which many people associate with last-century Fordist approaches to manufacturing and services, is transforming itself to take on board a central role in resource-based and knowledge-based views of sustainable competitive advantage. Key resources, routines and capabilities are tied up in creating and delivering goods and services to cus-

tomers, and in managing not only operating units but also entire supply chains. For models of what post-Fordist operations management might look like, she proposes, creative and knowledge-based industries such as television and motion picture production, museums and libraries, and open-source software offer a glimpse of the way to organise in the future.

Douglas Holt was the keynote speaker at the Hamburg Marketing Summit in Germany, the inaugural event of the Hamburg marketing club, held in the City Hall. 250 managers and experts met at this prestigious event, modeled on the World Economic Summit in Davos, and discussed trends in brand management and marketing. For more information and a live recording go to www.welt.de/go/summit. Holt also presented his cultural branding model to an audience of marketing and advertising professionals at seminars in Santiago, Chile and Mexico City, sponsored by Harvard Business Review.

Dimitrios Tsomocos is about to publish "A Model to Analyse Financial Fragility", (with C.A.E. Goodhart and P. Sunirand), *Economic Theory*, v. 27. pp. 107-142, 2006. This paper sets out a tractable model which illuminates problems relating to individual bank behaviour, to possible contagious inter-relationships

between banks, and to the appropriate design of prudential requirements and incentives to limit "excessive" risk-taking. The authors' model is rich enough to include heterogeneous agents, endogenous default, and multiple commodity, and credit and deposit markets. Yet, it is simple enough to be effectively computable and can therefore be used as a practical framework to analyse financial fragility. The model also indicates how monetary policy may affect financial fragility, thus highlighting the trade-off between financial stability and economic efficiency.

The European Accounting Association (EAA) granted a new award to **Anthony Hopwood** for his significant contribution to the development of the EAA. Two of Anthony's very close collaborators, Kari Lukka, EAR Editor and Professor of Accounting at the Turku School of Economics and Business Administration, and Gerry van Dyck, General Secretary of the European Institute for Advanced Studies in Management, outlined Anthony Hopwood's outstanding academic achievements and gave a testimony of 29 years of close collaboration. The "Anthony Hopwood Award for Academic leadership" will be granted occasionally – every three or four years – to outstanding scholars who have contributed substantially to the development of the discipline and the EAA.



Vice-Chancellor John Hood at the Private Equity Forum held at the Saïd Business School, Oxford.

In *Linking Industry and Ecology*, **James Tansey** (with Ray Côté and Ann Dale) explores the origins, promise, and relevance of the emerging field of industrial ecology. Its aims are threefold. First, it reminds us that humans, their products, their industries, and their communities draw resources from and discard waste back into the same biophysical environment, often at unsustainable rates. Thus, it serves to educate people about the nature of the emerging concept and field of industrial ecology. Second, the book situates industrial ecology within the broader range of environmental management



Linking Industry and Ecology, University of British Columbia Press, \$85.00 Hardcover, ISBN: 0774812133, 256 Pages

strategies and concepts, from more shallow approaches such as pollution prevention through life cycle management to deeper practices such as dematerialisation and ecological design. Third, it provides a compelling argument for the need to think ecologically to develop innovative and competitive industrial policy.

As attempts to reform public sector pay systems continue, **Ian Kessler** spoke at a conference of practitioners, policymakers and consultants on the state of performance pay in the public sector, "The Pay Agenda in the Public Sector". Other speakers included the General Secretary of the Public and Commercial Services Union and remuneration experts from the Department of Trade and Industry, Equal Opportunities Commission, PricewaterhouseCoopers and PA Consulting.

In October 2005 Ian and his colleagues **Paul Heron** (Templeton College) and Stephen Bach (King's College, London) held a Conference at Saïd Business School to disseminate the findings from their recently completed two year ESRC project on assistant roles and job boundaries in the public services. The Conference was attended by around 40 national and local policy makers and practitioners from health, education and social care. Fuller detail of the project can be found on www.templeton.ox.ac.uk/assistants. Ian has also written a new chapter on employee remuneration for the fourth edition of *Managing Human Resources*, Oxford: Backwell, Bach, S. (Ed) (2005). He provides an up to date review of contemporary developments in pay and reward concentrating on how approaches to reward have been influenced by changes in the nature of competition, shifts in the composition of the workforce and greater regulatory pressure.

Jonathan Reynolds was a guest and keynote speaker at the recent 12th Asian Retailers Congress in Beijing. Reynolds spoke on the challenges faced by the modernisation of the Chinese retail sector and reviewed the experiences of UK retailers B&Q and Tesco in generating customer insight in this fast-growing market. Retailing is considered a key growth sector by the Chinese government, with active players including Carrefour and Wal-Mart. Marking this importance, the conference was hosted at the Great Hall of the People by Vice Premier Wu Yi. At the same time, he paid a visit to Tsinghua University's new Chinese Centre for Retail Research, where he has been

invited to join the Advisory Board. "Tsinghua University is one of China's premier universities and a link between Tsinghua, and Oxford in respect of retail research will open up tremendous opportunities for collaboration," comments Jonathan. "It is very timely in the Oxford Institute's 20th year of activity to welcome the opening of the first centre of retail research activity in China."

Jonathan Reynolds hosted the 52nd meeting of the Oxford Retail Futures Group on 10 October to consider the role of retail branding in a multi-channel environment. Bill Laird, Operations Director of the newly-merged Midcounties Co-operative, provided the view from the physical store, while John Ashton, Marketing Development Manager at John Lewis Direct, gave the view from the virtual world. As well as an audience of senior managers and directors from UK retail and retail-related companies, a group of Norwegian retailers currently working with Reynolds on a collaborative Anglo-Norwegian research programme also took the opportunity to attend the event. In the discussion that followed it was interesting to note that the future of retailing faces similar issues regardless of geography, and that the value of a group such as this lies as much in sharing what goes wrong as what goes right, and in finding innovative solutions as well as discovering ideas for the future.

Research on retail productivity led by Jonathan Reynolds has been showcased in a special issue of the *International Review of Retail, Distribution and Consumer Research*. The research undertaken by an Oxford-based team in 2004 is the centrepiece of a seven-strong series of responses by international experts in productivity, aimed to provide a wider discussion of issues in this important field.



BBC Chairman Michael Grade.

based at the University of Leeds.

Greatest achievements:

- Surviving an Arthur Andersen Leadership Event in the Lake District (as part of research fieldwork on socialisation and accountancy) – but do not ask me to do anything like it again!
- Seeing the smile on the face of students, who have struggled with their accounting, when they realize they have finally 'got it' (especially when they tell you they no longer hate you).
- Daring to be technical in a critical environment and critical in a technical environment – i.e. setting off on the journey to become a critical accounting academic (from a very different background) and the various institutional challenges faced so far...

Thinking about: How to understand transdisciplinarity and the opportunities that this way of being knowledgeable holds for the integration of critical and technical approaches to becoming and being accounting literate.

Hopes to achieve: If, at the end of my career if not before, I could feel that I have contributed to figuring out how the lessons of critical accounting can be made to have real practical effect then I like to think I will be happy.

Other passions: Elvis Presley (and lots of other music); taking time to 'smell the roses' (noticing the colour and vibrancy in life that we've missed whilst we've been busy); exploring the delights of the countryside around my home; comedy.



Lucy Kimbell
Clark Fellow in Design Leadership

Brief biography: Lucy Kimbell has led design teams developing software, web and mobile projects; set up design practices; designed events, systems and processes; taught Interaction Design; collaborated with social scientists, software developers, scientists, and artists; and lived and worked in Sudan, Spain and Poland.

Greatest achievements:

- Learning how to make things

(although I have to re-learn this every project).

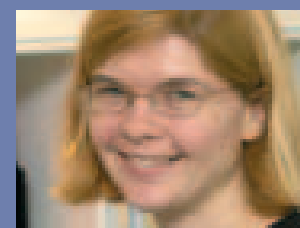
- Not noticing disciplinary boundaries.
- Changing the way clients and collaborators think and work.
- Realising how little I know.

Thinking about: What makes design-led research different from other kinds of research; how to design processes, networks, interactions and engagements; inclusive or participatory design and user-centred design and what these mean for organisations; how a design-led organisation might behave.

Hopes to achieve: Making the Saïd Business School a place for new, critical thinking about the role of design in organisations and society; creating links for faculty and students to designers, design educators and

people within organisations responsible for design thinking; creating an amazing MBA elective that gets people thinking and talking.

Other passions: Collaborative authoring, live art, tai chi, and trying to minimise negative environmental impacts from my choices



Dana Brown joined the School on 1 July as University Lecturer in International Business. Dana joins us from MIT where she successfully defended her doctoral thesis in political science in February of this year.

Oxford Business Alumni Annual Lecture

The risk, the whole risk and nothing but the risk

By Bruce Carnegie-Brown, President and CEO of Marsh Europe and Middle East



It is the role of most professional service advisors to help their clients to identify and deal with the risks that they are facing.

But the role played by the insurance industry is undervalued. Having made the transition to insurance, after more than 20 years in investment banking, I would like to explore some of the reasons for this.

One way to appreciate a large corporate client's view of the relative value of the banking and insurance industries is to spend time in the notes to the Annual Report and Accounts. Under the heading, "Risk Management", you can find copious notes on policies to manage interest rate

risk and currency risk and also on their pension liabilities. But despite what we all know to be the increased natural hazard risks in the world, and despite significantly greater operating risks, these kinds of risks are much less well explained.

So too are a company's policies towards buying insurance cover. Insurance premiums rise and fall cyclically. During periods of high prices, some forms of cover may be unavailable, or it may be deemed too expensive by the insured. If less cover is purchased, then more risk is retained. But nowhere is this change of risk cover set out in the notes to a company's accounts. Yet I would argue that the

insurance market is more volatile – and the outcome of large insurance claims is less predictable – than for many financial risks.

By most measures the banking industry is considerably larger than the insurance industry. But, today, banks do not knowingly take significant risks. Insurance companies, by contrast, even in a good year pay out on average 70 per cent of the premiums received in claims. In short, much more risk is transferred from corporate balance sheets to the insurance industry than to the banking industry, but that is not reflected in the value recognised by the industry's clients. This failure to get its value recognised has a direct impact on its return on capital, which for the global insurance industry since 1980 has averaged 8.5 per cent per annum, compared to, say, the US banking industry where the return has been 15 per cent per annum. So why is the insurance industry valued less highly than the banking industry?

My answer is that its value has not been recognised because the insurance industry has failed to develop certain risk-management tools. Simply put, people buy insurance to have "peace of mind". But if the volatility of the insurance market itself is greater than the volatility of the underlying risks it is designed to protect, then insurance will have little purpose.

So how does this volatility arise and how can it be reduced? First and foremost, volatility in the insurance market is driven by capital availability. The industry is characterised by long periods when capital is readily available, followed by short periods where the capital is suddenly used up in paying unforeseen claims. These cause prices to rise dramatically.

In the insurance market, risks are traded once on each renewal. By contrast, in banking markets, when a risk position is created, it is actively traded. This can literally be from minute to minute. I mentioned earlier that the underlying growth of insurance markets is closely correlated to GDP growth; so too is the underlying growth of the banking industry. The difference in the overall growth rates of the two industries over the last 20 years has been the explosive growth in derivatives markets related to these cash assets.

The tools and techniques of the derivatives market have offered immense growth to the banking industry and they have offered more tools to borrowers and investors alike in managing their financial risks. So why have not similar tools and techniques developed in insurance markets?

There are a number of reasons: the first is the absence of independent and reliable data on activity in the insurance



Bruce Carnegie-Brown is President and CEO of Marsh Europe and Middle East.

market. It is not possible to trade risks without access to reliable and independent data. And poor data leads to insufficient analysis of conditions driving the market place.

Second is the term of contracts offered by the market. More than 90 per cent of all insurance contracts have a one year term. Yet longer dated contracts would reduce the risk for both insurers and insured of sudden changes in market pricing. Participants could reduce their risk by extending the average duration of their insurance contracts. And if contracts of two, three or four years were all available, the market could learn more about its clients' risk appetite. It could create a risk pricing curve which would enable a forward market in insurance risks to develop. A derivatives market would eventually be born, which would enable insurance underwriters to price and manage their capital across the cycle more efficiently, as well as having a beneficial impact in reducing the volatility of insurance prices.

The third reason why insurers have not developed a derivatives market is the difficulty with standardising the terms of insurance contracts and with the certainty of the contract itself. Insurance brokers and underwriters argue that, particularly for large commercial risks, contracts are specifically tailored to each client and not capable of the standardisation necessary to commoditise the underlying units of risk and, therefore, to trade them. But I

would point out that credit markets (for example), where definitional issues are at least as complex as contract definitions in insurance, have made significant progress in standardising contracts.

A final reason why the more active trading of insurance risks is not only desirable but also necessary for the insurance industry, is to reduce its capital intensity. Every day the insurance industry prices its products without knowing their true cost. In lending banking, the amount of any loss is at least capped by the amount of the loan. You cannot lose more than the principal you have put at risk. This is not true for insurance.

To reduce the capital intensity of their activities, banks have not only traded their capital more actively, they have also diversified into fee-based services. Insurance underwriters' revenues, on the other hand, continue to be derived exclusively from two sources: underwriting risk and interest income earned on the premiums paid. In stark contrast to the banking industry, the insurance industry is as capital intensive today as it was 20 years ago.

From these perspectives, I draw the following conclusions. The insurance industry has failed to generate adequate return for the value it provides, because its risk concentrations are too high, the tools to manage the underlying risks are too few and the quality of its contracts is too uncertain. However, the solutions to all of these issues lie in the industry's hands. ■



Craig Conway is former President and CEO of PeopleSoft Inc.



From turnaround to target

Craig Conway tells the story of PeopleSoft – its financial turnaround and its hostile takeover by Oracle.

In 1999, when I joined PeopleSoft as President and Chief Executive Officer, I was fully aware of the challenges that we faced. I was aware that the stock had lost 85 per cent of its value in the past 18 months, and that employee attrition was above 30 per cent per year. I had read technology analyst reports recommending that clients not purchase PeopleSoft software.

But I joined PeopleSoft because I saw something more. Not least, I saw a company with a great brand name, a history of technology leadership and a strong employee culture. I immediately set about a seven-step process to reinvigorate the company.

Step one was to stabilise the team. I let the management know that they would determine the company's success. At the same time, I began to show generosity, with both short and long

term compensation. Step two was to “take inventory”. In the event, I found problems up and down the company and convened a meeting with my management team to tell them so. The message sent by that type of meeting is that you really understand how difficult things are.

Step three was to find something that could change the world. Not a vision, but a tangible development which would put us ahead. You need to change the world somehow to get a second chance at leadership: for PeopleSoft this meant bringing to the market a pure, internet architecture for business applications.

Step four was to recruit and retain superstars at any cost; step five was to cheerlead continuously; step six was to outreach to customers, press and analysts; and finally, step seven was to persevere.

Two years later these seven steps were making a significant difference. Operating

profits were strong. Cash flow was more than \$100million per quarter. PeopleSoft's stock was the number one performing stock on the NASDAQ stock exchange in 2001.

All of this made me feel very good about PeopleSoft. But at the same time, I began to realise that the environment and the economy were changing. I also began to accept that PeopleSoft – like Cisco and Microsoft and Oracle – had become an earnings-driven stock, and that we would have to find a way to grow earnings even in a down economy. That was when I began to think about acquiring other enterprise software companies.

We began a secret project to evaluate potential targets. We looked at everybody. When I finally presented a plan to acquire JD Edwards to our own Board of Directors, it was discussed and debated extensively. But in the end, all agreed. And on June

2nd, 2003 we made the acquisition and became the second largest enterprise software company in the world.

Looking back I remember feeling quite proud of this industry-changing acquisition. Those feelings would last another three days.

On Friday June 6th, at 1:30 in the afternoon, I had just landed at Schiphol Airport and was driving to Rotterdam. There was a cell phone call to one of the executives in the car saying that Bloomberg news service was reporting that Oracle would acquire PeopleSoft.

Thus began one of the most difficult and confrontational tender offers in history.

From the beginning Oracle's offer did not seem genuine. Instead, it seemed to be some kind of attempt to disrupt the JD Edwards acquisition. The tender offer was too low; there had been no attempt by Oracle to directly contact us. And why else would Oracle continually talk down the value of an asset it really intended to purchase?

There was one thing that made this tender offer totally different from any other.

When an ice cream company is under a hostile tender offer, no one stops buying their ice cream. But enterprise software is different – it is a long term commitment. Customers of enterprise software expect their software to be available and supported for years to come.

In public interviews, Larry Ellison of Oracle kept saying that the PeopleSoft software would not be supported long term. PeopleSoft, in response, needed quickly to find a way to give customers the assurance and confidence they needed to continue buying.

Here I can only briefly describe the five phases of the hostile tender offer.

The first phase was a “Call-to-Arms”. PeopleSoft's future had been threatened. We needed to mobilise everyone to preserve the company, and we needed to do it fast. For the first 90 days we did this with success, and the feeling was exhilarating.

The second phase was “Determination”. After the first 90 days, it was no longer exhilarating to be in a fight with Oracle, but we were determined to remain viable. Justice departments in the US and Europe had begun to consider whether the tender offer was anti-competitive. This second phase should have been the last phase if this were like any other hostile tender offer.

But it wasn't and we entered a third phase.

The third phase was “Stagnation”. The end of the year had come and gone without a decision by the US Justice Department or the European Commission. Oracle was still pressing. By now both our customers and our employees were becoming concerned at the length of time without a resolution.

The fourth phase was “Judgment”. PeopleSoft's Board of Directors had resisted the tender offer from the beginning because it believed the offer was too low and the transaction would not be allowed to proceed on antitrust grounds. Now the second premise was being tested in a federal courtroom in San Francisco California, in front of a single judge. Finally, the decision was announced – the US Justice Department had lost its challenge to the tender offer.

At this point, we entered the final phase, “Optimal Value”. Now it was simply a matter of whether Oracle could offer a compelling price for shareholders.

It would take a while to agree on a price, but in the meantime another case was being brought by Oracle, alleging that PeopleSoft's Board of Directors had not done their fiduciary duty, specifically because they were unduly influenced by their CEO. Two days before this trial began, the board removed me as CEO, and six weeks later the company announced a deal with Oracle.

As I look back on this long, almost surreal 18-month hostile takeover, I draw three conclusions.

First, time favors the acquirer. Most companies can rally a defense for six months; but eventually the company will begin to show signs of incredible daily stress. Second, the larger the acquirer, the less effective the regulatory review. Regulators like the US Justice Department treat the largest companies with extreme caution; they realise that larger companies have large, talented, and well-connected law firms, so a decision not in their favour is probably going to be appealed. Third, PeopleSoft's defence against the hostile takeover, although long and ultimately unsuccessful, did achieve results. The final price for PeopleSoft was far higher than the original offer. Also, Oracle was forced to support PeopleSoft products and customers for at least ten years, providing at least some protection of their investment. Finally, the process raised the awareness of PeopleSoft's employees and management – most of whom have now gone on to significant positions in other companies. ■

Next year will mark ten years of the Saïd Business School. The School has much to be proud of: a world-class MBA, a state-of-the-art new building and an ever-broader array of interdisciplinary research centres.

In the published business school rankings Saïd is becoming a big hitter. But until now, executive education has largely been a separate activity, conducted at Oxford's Templeton College two miles outside the city. True, College and School have been brought together successfully in recent years under the aegis of Oxford Executive Education (OEE). But, as the School's Dean Professor Anthony Hopwood says, "OEE didn't represent final equilibrium: its very success suggested the logic of the next step – full integration."

That step has at last been taken. From mid-November Saïd takes over responsibility for executive education and operate as a full-service business school offering everything from undergraduate

degrees to board-level programmes. Templeton will have a continuing key role as a specialist graduate college in management studies.

So what prospects face Oxford in the choppy currents of executive education? Executive education is big and booming business but notoriously demanding and competitive. Companies find old "cookie cutter" functional courses increasingly a turn-off. Instead, they are looking for two very different things. The first is hard value-added – a targeted focus to add specific competitive edge in today's tough global markets. This is reflected in the surge in customisation, co-design, partnering and "real-life" action projects.

More broadly, organisations are seeking some forward-looking insight or approach that will help them unlock the vital springs of creative knowledge, energy and leadership to meet challenges that they themselves do not yet entirely grasp; hence a parallel emphasis on culture change, individual coaching and continuing, and whole-person develop-

ment. Larger issues of values and society come into play here. One European high-up in Microsoft recently commented: "In ten years the shareholder will no longer be the number one stakeholder for companies like Microsoft: it will be society." Oddly – or not so oddly, given recent Enron-type scandals – one of the things that business is seeking from business education is a new business morality – a more open and responsive replacement for the old City gent's stiff-collared integrity.

Oxford is as yet a smallish fish in the rising ocean of executive education. But Oxford business academics are buoyantly confident. And if you set the complex pattern of business needs against the University's track record and potential strengths, that confidence does not seem unwarranted.

For one thing, the roots of Oxford management studies lie in executive education. Since it was founded as the Oxford Centre for Management Studies in 1965, Templeton has specialised in executive education and built up a formidable body of experience, particularly in customising programmes, change management and leadership development. Templeton's Dean, Professor Michael Earl, and his colleagues have attracted an impressive array of top international clients including BMW, O2, BAe Systems, Deloitte, PricewaterhouseCoopers and the

European Patent Office. With its fellows joining the School as full members, Templeton's highly evolved pedagogic DNA will go forward as a key strand in Oxford management education.

But, within a bigger body of over 60 faculty, it will be interwoven with other key strands. The integration will align a range of complementary strengths. Templeton's expertise in teaching companies and senior executives matches the School's in undergraduate and MBA teaching. The School's expertise in finance, science enterprise and international marketing and brand development are complemented by the college's institutes in retail, human resource and information management. Together, these strengths will support a much broader management education offering.

The School, says Professor Hopwood, will offer a comprehensive portfolio of programmes. As well as addressing the development needs of a range of organisations at a variety of levels these will provide cradle-to-grave career support for individual executives: "Our portfolio will target young professionals – bright, young, mobile professionals working in cutting-edge knowledge-based organisations looking for more educational input into their careers. Once, a two-year MBA was all that was necessary for a 40-year career. No longer! We are likely to develop a new kind of support system: a twelve-month MBA with regular updates to reflect new knowledge."

Generating that knowledge will be the School's specialist research centres such as the Clifford Chance Centre for the Management of Professional Service Firms and the James Martin Institute for Science and Civilization. "We will be developing a range of specialist courses built around the Science Enterprise Centre and the new Skoll Centre for Social Entrepreneurship as well as hopefully more on finance," says Professor Hopwood.

Beyond these specialisms stretch Oxford's vast interdisciplinary resources. Already courses such as the Oxford Programme on Negotiation draw heavily on University strengths in politics and international relations. We shall see much more of this in future. "Oxford is uniquely well placed to explore the broader context of business, and its management faculty well qualified to envisage and anticipate future developments," comments the Vice-Chancellor, Dr John Hood – himself, incidentally, a former MPhil Management student.

The new arrangement will open other

avenues. Academic accreditation is one of the things business is increasingly looking for in executive education. Integration will encourage closer links between executive education courses and degree programmes. Courses could count as completed modules in Oxford's Executive MBA. "These will not be baby school courses," says Hopwood. "The aim will be an unparalleled degree of integration with our other programmes."

Globalisation and the battle for young talent also increasingly concentrate business minds. The new arrangement will also bring broader opportunities for corporate recruitment and participation in the School's growing web of international networks. "We want companies and other organisations internationally to see it as the natural decision to approach Oxford for the full range of their development needs," says John Hood. And the traffic will not be one-way. The School will be getting back vital information and experience to feed into its other activities.

Oxford's new management studies strategy will have at its heart a world-class business school and, at Templeton, a collegiate community fostering individual development and international dialogue. Graduate student numbers have grown markedly there in recent years: ten years ago it admitted only eleven students; this year the figure will be 160. Free of direct responsibility for Oxford executive education, it now has the opportunity to become the graduate college of choice for management studies graduates bringing together an international community of high calibre students and faculty, eminent visiting scholars and business and other leaders.

Surveying the rich new landscape of Oxford management studies, Templeton's Dean Michael Earl concludes that "the realisation of a full-service business school with an established track record, complemented by a specialist graduate college dedicated to management studies, creates a unique capability to serve and work with the business leaders of today and tomorrow".

Stephen Barclay, son of Oxford Management Studies' original benefactor, Clifford Barclay, agrees: "When my father, Clifford Barclay helped set up the Oxford Centre for Management Studies, he never envisaged that Oxford, within 40 years, would have both a world-recognised business school and a specialist graduate college in management studies, with executive education recognised as a key part of the offering. He would have been delighted and proud." ■

New horizons

Peter Snow investigates Oxford's new management studies strategy.



With nearly 10,000 employees in around 400 offices spanning the globe, SAS is the world's largest privately held software company. Yet Jim Goodnight, the company's co-founder and CEO, and Art Cooke, President of SAS International, still find that many people don't know what SAS is or what it does.

So just to be clear, SAS (pronounced "sass") is not a Scandinavian airline. The initials used to stand for "statistical analysis software". However, since the company was first founded in North Carolina nearly 30 years ago, things have moved on and what SAS does now goes way beyond producing software. The term no longer stands for anything, but Goodnight says that the company itself very clearly stands for "business intelligence". And business intelligence, he is keen to make clear, is for

executives in the boardroom, not just for programmers.

SAS software solutions are used at around 40,000 sites around the world, including 96 of the top 100 companies on the Fortune Global 500. The range of applications is staggering.

Take, for example, SAS' involvement in the banking sector. The company provides a sophisticated anti-money laundering solution that can help banks. "There are hundreds of different "scenarios" in which money-laundering occurs," says Goodnight, "so we enable banks to scan hundreds of thousands of records looking for particular patterns." Other applications of SAS software in this sector include helping banks such as HSBC to detect credit card fraud, and improving the way risk is managed.

Then, there is SAS' work in the defence

industry. The company is working with the US armed services on "intrusion detection" – preventing people from gaining access to the armed forces' digital network. "There are people who try to get in very cautiously, very slowly, over a long period of time," Goodnight explains. "Those are the hardest to detect."

In pharmaceuticals, SAS software is used to analyse almost every clinical trial that goes on around the world. SAS is developing a drug development platform that is used to store all the data, the analysis, and the comments from doctors and patients involved in the clinical trials, as well as from researchers, helping companies to prepare to go to the FDA with new drug applications.

SAS software is also used in human genomics – helping to isolate SNPs (pronounced "snips"). These are DNA sequence variations that occur when a single nucleotide in the genome sequence is altered. Although more than 99% of human DNA sequences are the same across the population, variations in DNA sequence can have a major impact on how

humans respond to disease and drugs. This makes SNPs of great value for biomedical research and for developing pharmaceutical products or medical diagnostics.

Retail has been one of the last major sectors to realise the capabilities of SAS' software and is a major growth area for the company. SAS works with major retail customers, such as Home Depot in the US, to create models that help with customer selection for cross-selling, with price optimisation, with merchandise planning – how things should be laid out in stores – and with making sure that local stores get the right products and sizes.

Jim Goodnight's personal passion and the focus of his company's greatest philanthropic efforts, is education. He and his wife, Ann, co-founded Cary Academy in 1996, an independent college preparatory day school for students in grades six to twelve, with the goal of creating a model school for integrating technology into all facets of education. Goodnight, who is a former professor of North Carolina University, has also endowed several



SAS UK headquarters.

professorships at his alma mater.

"Western countries are all falling behind in terms of the number of engineers, scientists, and technology people that we are producing at our universities," warns Cooke, whose remit includes the Asia Pacific region. "Soon, 90 per cent of all engineers and scientists will live in Asia, because we have failed to stimulate our kids into being interested in this area. India and China realised two decades ago that they had a chance to flatten the world out if they educated their people – and that's what they've been doing. Meanwhile, we have been sitting on our heels."

Sitting on its heels is not something SAS can be accused of. The company's private ownership enables it to take a long-term view of business development and to commit a whopping 26 per cent of the company's \$1.53 billion in revenues to R&D each year. Most of this money is currently going to expand its enterprise intelligence platform capabilities, ensuring that SAS solutions remain the best on the market.

So what has made SAS great? Cooke attributes the secret of SAS' success to common-sense rules. "Make sure revenues are greater than expenses. Keep your customers happy. And value your employees, because they are the intellectual capital of your company."

For eight consecutive years, the company has been listed in the top 20 of Fortune's "100 Best Companies to Work for in America". In addition, SAS has been listed by Working Mother as one of the 100 Best Companies for Working Mothers thirteen times and was recent featured as "The Best Place to Work" on the Oprah show. All that, and you get free M&Ms on Wednesdays.

SAS, Goodnight stresses, was one of the first real knowledge companies, with products coming from "between the ears" of highly trained, intelligent people. "Most of what the company does walks out of the front gate every evening," Goodnight says, "and my job is to get them back the next day." ■



Jim Goodnight is CEO of SAS Inc. Art Cooke is President of SAS International.

When knowledge is power

Business intelligence has moved into the boardroom, say Jim Goodnight and Art Cooke of SAS.



The Lubbock Lecture: Trust and economic policy

Ed Balls explains why 1997 marked a decisive change for the better.

Is it right for this government to take the credit for the stability and rising economic prosperity that we have experienced over the last eight years?

The Chancellor of the Exchequer regularly starts his Budget statement by pointing out that we have experienced the longest period of uninterrupted economic growth since 1701, when records began. But the Conservatives have consistently claimed that it was the policy innovations that they introduced after Britain left the Exchange Rate Mechanism on Black Wednesday, September 16th 1992, which established the platform for the stability we have subsequently enjoyed.

I want to explain why I disagree with the revisionists and argue that it is right to see May 1997 as the decisive break with the past. My case is, in part, based on the improved economic outcomes we have seen since that date, in terms of lower inflation, unemployment and interest rates. But these economic facts alone do not capture why 1997 was the turning point.

I believe that the decisive break was the rebuilding of trust in the institutions of British economic management, which began with Bank of England independence in 1997 and has continued in monetary and fiscal reforms since then. These institutional reforms established clear targets for policy against which the public could judge performance; they changed the relationship between Government, Parliament and the Bank, setting out for the first time clear procedures in statute; and they required much higher levels of transparency in decision-making than had ever been seen in British economic policymaking.

Let me explain why, in the modern global economy, establishing and then sustaining trust is so important.

This, in its simplest terms, is the problem. A new government arrives in office and declares that its goal is long-term stability with low inflation. But no one believes it. Everyone assumes that, in the year before the next election, the government's incentive will be to cheat, loosen policy and dash for growth. Everyone therefore expects inflation to end up higher – and they raise their wage demands accordingly. The new government ends up with a tighter policy, slower growth and higher unemployment than it would have had if only people had believed its promises.

So the challenge for a government committed to pursuing long-term progressive goals is to demonstrate – in a credible way – that it will not do so at the expense of the stability of the economy.

When the Conservative government came to power in 1979 their solution to the problem of credibility and trust was monetarism. By this they effectively aimed to remove discretion from policy-making. They hoped to do this by publicly pledging that they would set interest rates to meet certain money growth targets, in the belief that this would deliver low inflation.

The problem was that – in the face of global financial integration and deregulation – what had seemed to be a stable relationship between money and inflation was collapsing, and the money supply persistently rose well above the targets the government set itself.

Persisting with their fixed rules, as monetary aggregates ran out of control, proved disastrous. The government's declared commitment to its goals – to meet money supply targets or, later, to preserve the parity in the ERM – became increasingly unbelievable. By 1997, inflation may have fallen to new lows. But so had the willingness of the British people to trust their Government on matters of economic policy.

The election of a new government in 1997 provided a unique opportunity to rebuild trust by establishing a modern macroeconomic framework for Britain. What was needed was a new pro-stability but post-monetarist model – based on what I have described elsewhere as “constrained discretion”.

Constrained discretion recognises that the discretion necessary for effective economic policy – short-term flexibility to meet credible long-term goals – is possible only within an institutional framework that commands market credibility and public trust, with the government constrained to deliver clearly defined long-term policy objectives and maximum openness and transparency.

It was to re-establish trust in British economic policymaking that the new Labour government decided to move so quickly and decisively to establish the independence of the Bank of England in May 1997 and establish new fiscal rules enshrined in legislation in the Code for Fiscal Stability.

To establish credibility, we relied on three pillars. The first was the setting of clear, long-term policy, against which policy decisions and track record could be judged, and around which a shared national economic purpose could be built. In monetary policy, for example, the government introduced a single inflation target of 2.5 per cent, rather than the ambiguously defined inflation target we inherited of “2.5 per cent or less”. As a fiscal counterpart to

the inflation target, the government also adopted its two fiscal rules, namely, the golden rule (that we shall borrow only to invest over the economic cycle) and the sustainable investment rule (that net debt as a proportion of GDP will be kept at a low and stable level over the economic cycle).

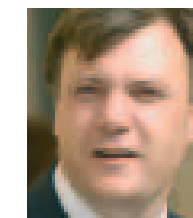
The second pillar was the introduction of proper procedures for decision-making so that both monetary and fiscal decisions were made, and seen to be made, in the interests of achieving their stated objectives. This made it very difficult for the government to cheat by breaking promises or aiming for undisclosed objectives.

The third pillar was transparency and accountability – so that decisions were made, and seen to be made, properly, with decision-makers held responsible for what they had done, or failed to do. In this context, the public and markets could see that both monetary and fiscal decisions were being taken for sound long-term reasons and in order to support the government's wider objectives for living standards and employment.

I believe that the government's track record since 1997, in both fiscal and monetary policy, amply illustrates the benefits of the institutional changes that have been introduced.

In fiscal policy too, progress has been significant. During the 1980s and 1990s, fiscal policy objectives were not well specified, and changed frequently. Between the early 1980s and the mid 1990s, at least eight different fiscal policy objectives can be identified – roughly one every two years. But now the combination of the Code for Fiscal Stability and the transparency of the system mean that it will be very difficult for any government to drop the current fiscal rules without a credible alternative. Whether the government is on track to meet its fiscal rules has become the key test of the credibility and sustainability of fiscal policy-making. The result is that macro-fiscal policy and the fiscal rules are now central to the Budget-making process and are subject to a high degree of public scrutiny.

The lesson we can draw from the experience of British macroeconomic policy is that institutional and constitutional reforms in British policymaking in general can lead to better decision-making and can restore public confidence that decisions are being made, not for short-term advantage but for the long-term good of the country. This can enable a left-of-centre government to combine economic stability with progressive policies – which is why I believe that 1997 did mark a decisive change for the better. ■



Ed Balls is the Member of Parliament for Normanton and was previously chief economic adviser to the Treasury.

What makes Microsoft great?



It takes more than great products to make a great company, says Patrick de Smedt

Patrick de Smedt is Chairman of Microsoft EMEA.

When I joined Microsoft 22 years ago, we generated annual revenues of \$30 million on a worldwide basis. Today we do that in approximately one hour. Change – embracing it, recognising it and adapting to it – has been the hallmark of those 22 years, as it will be in the years to come.

A company's competitive success today depends on how well it attracts and develops talented and innovative people who can manage complexity. This puts a premium on multi-disciplinary skills; on continuous learning and education; on

flexibility and multi-national teamwork. At Microsoft we take these issues very seriously, and over the years we've seen some fundamental success factors emerge.

The first success factor is innovation. When we talk to people about joining our company, whether they are young graduates or seasoned managers, they want to know what big bets we are making as a company. The younger recruits especially are looking to Microsoft and wondering, "What kind of company will this be in 10 or 15 years when it's our company?" They are making a bet on the company and they are betting on our ability to innovate.

The second success factor is responsiveness to customers, which has to go hand-in-hand with innovation. Over the last five years we have been working hard to make sure we have the customer at the centre of our focus. We have conducted countless interviews and really delved into the way our business works. We have radically changed our organisational structure into seven business groups, so that customers know that we listen, we learn, we improve and we respond at all levels of the company. We empower our employees so they can make the right decisions; but we also make them accountable for the experience that customers have with Microsoft.

The third success factor is the vision and the set of values that guide the way a company does business every day. At Microsoft our vision has evolved as the world and our business have changed. It now reads: "Enabling people and business throughout the world to realise their full potential". This vision is our big-picture goal, running through everything we do. What hasn't changed, however, are the core values that guide our decisions and investments. These values include accountability, openness, respect, awareness of our own mistakes, integrity and honesty.

Our approach to living our values is to hire the best and enable the best to give the best of themselves. We regularly test our operations against our values. We also set big goals for the company: for example to help train 250 million people worldwide by 2010 with the IT skills they need to succeed in the twenty-first century. We invest in and join partnerships to foster digital inclusion, education, lifelong learning and local economic growth; and we encourage our employees to volunteer some of their working time at local level and with the United Nations, putting technology to work in refugee camps, schools and learning centres in post-conflict situations such as in Afghanistan, East Africa and the former Yugoslavia.

These three themes – innovation, customer focus and ethical values – are more important than ever for business success and for responsible business leadership. They hold the keys to a profoundly important question for anyone in business: how am I helping my company to be a great company? This is important because today it certainly takes more than great products to make a great company. It also takes responsible leadership and a passion for enabling others to realise their potential. ■

Putting complexity back into business

By Paul Haynes

It has become commonplace to describe the world using terms such as globalised, connected, complex, reflexive, networked, dynamic, synergistic, informational (and the like). But how to derive a strong sense of this interconnectivity and interactivity from existing explanations or models in the management sciences is still far from obvious.

There are theories, models and methods from the last decade or two which have promised to deliver exactly this type of analytic power. Chaos theory, complex adaptive systems, non-linear dynamics and other science-derived models centred on a complexity paradigm were supposed to make us rethink the process of change. In the 1990s we were told that these revolutionary techniques would explain multinational corporations, mass extinctions, or ecosystems such as rain forests, or human consciousness. They were, after all, built on the same few rules. Unfortunately this complexity paradigm – a new theory of everything – turns out to have been hyped. It was a '90s fad, we now learn.

Well not quite. It seems instead that rather than having gone away, complexity, albeit in many different guises, has been undergoing something of a transformation. Gone is the hype of a complexity panacea, one based on a fairly neat analogy or a loosely interesting metaphor. Gone is the confusion between chaos theory (think butterfly effect, i.e., complicated behaviour derived from simple rules) and complexity (think self-organising patterns i.e., ordered structures emerging from complicated events and interaction). Instead researchers and academics from a wide range of disciplines have been busy developing models and methods based on complexity that are specific to their needs, often combined with, or adapted to, existing disciplinary frameworks.

This is far more revolutionary than it sounds. A wide range of problems are being addressed using complexity tools by management scientists, economists, sociologists and those interested in all areas of



health, education, policy-making, sustainability and innovation (or just about anything that involves organisations or networks). Indeed, at a recent complexity conference in Liverpool, in more than 20 different disciplinary streams, practical applications of complexity were outlined on more than 100 different problem areas. This is, of course, only a tiny fraction of the work that complexity is being employed to do.

This is still only marginal success at the edge of academic research, rather than a full account of interconnectivity and interactivity. Nevertheless, now that a series of tools has been developed, a community of complexity researchers is slowly forming, one with shared technical knowledge, with shared journals, university centres, research groups, conferences, message boards and, (soon, I hope) a users handbook.

Such a community is crucial because only through persistently addressing problems with appropriately developed and adapted methods or models can a new conception (OK, let's call it a paradigm!) sustain itself.

This revolution, therefore, is not a big idea solving big problems in one explanation or with one tool. The revolution is happening through the diligence of numerous researchers, each quietly getting on with the business of solving problems, modifying explanations and identifying interesting puzzles to solve using a range of intellectual tools.

If management science is to derive a strong sense of this interconnectivity, then complexity thinking is an important part of its future research programme. But the exact form that this complexity approach will take is itself an emerging feature, requiring more exploration and analysis by many quiet revolutionaries. ■

Paul Haynes is a Post-Doctoral Researcher with the Skoll Centre for Social Entrepreneurship. He is currently editing a Handbook of Complexity for Elsevier Inc, with Will Medd.

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