PAPER P3

(ALSO OF INTEREST TO E3 CANDIDATES)

PERFORMANCE STRATEGY

Nick Weller considers the risks associated with organisational change and the control methods used to ensure a successful implementation.

The effective implementation of strategy requires an appropriate process of change management. Change management, therefore, is a key element of the Enterprise Strategy (paper E3) syllabus. The effects of change and change management are also important in Performance Strategy (paper P3). There were numerous questions in the old P3 exam (Management Accounting – Risk and Control Strategy) about organisations facing different types of change. Similar scenarios will appear in the new P3 paper.

The first question in paper P3, which shares pre-seen material with its equivalents in E3 and F3, may well require you to consider the consequences of change. P3's examiner is likely to throw in new business developments in the unseen material and require you to discuss the associated risks and how control systems should manage the changes.

Let's consider the risks and controls associated with change in three stages: the decision to change, the implementation process and the results.

The decision to change

The first strategic risk at this stage is a lack of awareness that change is required, that customers' tastes are changing or that new competitors' strategies are likely to draw customers away from your business. Then there are the risks associated with the change – eg, developing new products, merging with a rival or investing in a new IT system. The resulting costs of such changes may greatly exceed the benefits. On the other hand, there may be opportunity losses from a failure to pursue changes that could have resulted in significant net benefits.

The 1999 review of UK corporate governance by Sir Nigel Turnbull highlights the need for businesses to respond to changing risks, stating that a sound internal control system depends on evaluating the nature and extent of the risks faced. The consideration of risks must be a regular item on the board agenda, according to the Turnbull report, which emphasises that boards should conduct a wider review of risks annually. Directors should consider changes in the nature and extent of significant risks – ie, those with serious consequences for the business if they materialise – and the company's ability to respond to internal and external changes. Boards should also consider whether the ongoing monitoring of risks in the company – the process that gives the board the information it needs to make its assessments – remains satisfactory.

When a business is considering a big change, it needs a structured process for analysing the transformation. A key element of this process should be that some proposals will be rejected at an early stage. The initial analysis should obviously include a thorough risk assessment in which expert advice may be required on the significance of potential risks and the

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feasibility of proposed actions. It's also important to consult stakeholders early on – for example, staff who will need to use a new IT system or customers who may be buying a new product.

A rigorous financial evaluation will also be key to this initial analysis. The organisation's investment appraisal processes have to be robust here. For example, using the wrong cost of capital, working to an inappropriate schedule or failing to consider different scenarios may seriously affect the quality of decision-making. The appropriateness and quality of the data used in the process will also require careful analysis. Issues include how much credence to give predictions of perhaps a very uncertain future. Other important aspects are the consistency and objectivity of data drawn from different sources. How heavily can senior managers rely on figures supplied by a department that stands to benefit from the significant investment being proposed, for instance?

A business will also need to consider non-financial feasibility. The technical aspects will obviously be important if significant changes are being proposed for information systems. Social and ecological aspects may be important, too, depending on the risks facing the business and its social responsibility policies. Operational feasibility may also be a factor. The board may decide against changes because it considers that they would be too disruptive to production, but, if it chooses to go ahead, the assessment of operational feasibility and the analysis of the changes required should have a big influence on the change plan.

Kurt Lewin's three-stage model of planned change highlights the importance of HR systems in preparing employees. It's important to let the whole organisation know how the change will be achieved, but such a communication is often not enough. The directors will need to share their vision for what the change should achieve and show their commitment to it. Appraisals should include discussions of what people feel about change and how their normal routines and relationships will need to vary. Employee development plans should be linked to change, giving staff extra responsibility as part of their participation in the process.

The change process

The main risks during the transformation are that it will take longer, consume more resources or cost significantly more than anticipated. The by-products of change – eg, operational disruptions and delays – may also be significant risks.

Perhaps the most important control method needed to ensure that the change runs smoothly is a thorough planning process. It can be helpful to follow models such as PRINCE2, which is covered in depth in paper E2. PRINCE2 includes a four-level hierarchy of plans:

- The overall plan, produced at the start of the project.
- A stage plan, produced for each step of the project, including budgets and tools such as Gantt charts for measuring the time taken and the resources required.
- Detailed plans as required.
- Individual work plans for all those involved in the change.

If the change needs to be validated before it can be implemented, a well-designed testing process will be required. This needs to have sufficient breadth to provide assurance that all requirements are being fulfilled. A new IT system, for example, will have to be tested for usability and security. Tests must simulate real conditions as closely as possible. If a new product is designed to be used domestically, for instance, the testers should be given that product to use at home.

Effective communication with employees and other stakeholders is as important during the change as it is before the process starts. This will ensure that everyone affected knows what's happening. But, if the change is to be successful, they may need to do more than know what's happening. They may also have to participate in testing or be put in situations where they need to practise new behaviour.

The organisation needs to put the right people in charge of managing the project to a successful conclusion. A change manager, supported by a committee or team, may be made responsible for promoting change, monitoring progress and ensuring that enough resources are being provided and used efficiently. If the board is to monitor change effectively, it needs to receive regular reports from the change manager and there should also be a system of exception reporting: reports need to be made if the process slips behind schedule or the costs vary significantly from the budget.

The success of the process may hinge on the action that's taken whenever things don't go to plan. Delays or cost overruns may be resolved by rescheduling, providing more resources or offering staff extra incentives to beat deadlines. Action may also be required if testing has revealed problems such as a failure to fulfil users' requirements. Significant amendments to the original plan should themselves be subject to rigorous analysis, including a consideration of the implications of sticking to it, and of the risks, costs and benefits of changing plan.

Controls over the implementation will depend on the speed of change. Where the process is gradual – eg, if existing and new IT systems are running in parallel or if

a new product is being launched in selected areas only – feedback from initial experiences can be used to determine how the full roll-out will proceed.

The results of change

The risk here is that the outcome will not be effective or as intended, even if the change process proceeds as planned. The new product launch may be a failure or the new information system may not work properly, for example. Changes may not be implemented as planned because systems or policies aren't properly aligned, or because employees haven't been taught the new skills required. Some failures result from problems associated with a corporate culture that encourages employees to resist new developments. Often, one change will lead to others, but there may be problems implementing these because of a failure to review the initial one and learn from it.

An organisation may have to establish new performance measures to gauge the success of the implementation. These can include targets – eg, for getting systems fully operational by a certain date. Targets will also be required for the associated organisational changes – eg, a deadline for a new reporting structure to operate after a merger.

Communication remains important once the implementation has taken place. Employees will need to know after a merger how they fit into the structure and strategy of the amalgamated company, for instance, or customers will need to know about new products. In turn, customers and employees need to be able to communicate their requirements for future support.

Education and training are key to ensuring that the change is effective. This may entail more than teaching people the skills they need to cope with new processes and products. Staff may require some persuasion that a new way of working will benefit both them and the business. Their initial experiences of new situations should be noted and the training adapted accordingly. Behavioural change may need to be encouraged through other methods – eg, promotions and pay rises.

If one change is to be the first in a series, a post-completion audit can help to identify weaknesses in forecasting the impact of the transformation and in the change management processes. The audit can also be a means of assessing the performance of the management team.

It's important for a business to understand the breadth of impact that any significant change can have on its operations and control systems. In P3 you will need to go beyond procedural controls and discuss how a business's control systems should assess the need for change and support its implementation. The effective management of the risks associated with a significant change is a crucial element of performance strategy.

Nick Weller is BPP Professional Education's CIMA publishing manager and author on paper P3.

Exam practice

Try the following question to test your understanding. The answer will be published in the next issue of CIMA's student e-magazine, *Velocity* (www.cimaglobal.com/velocity).

Company P offers telecommunications services in its home nation and three neighbouring countries. Its services include providing telephone lines and equipment, private networks and mobile phones. P's customers include private individuals, businesses and public-sector organisations.

The company is organised along functional lines, with the main functions including technology and development; sales and marketing; and operations.

P's annual report has recently set out the business opportunities that, the directors hope, the company will grasp:

- Expanding the existing telecoms business, both by acting on its own and by arranging partnerships with other suppliers.
- Entering joint ventures and strategic alliances with partner companies based in a number of countries outside the territory that P currently covers.
- Diversifying into other multimedia services.

P is considering an investment in new systems, technology and quality improvements to allow it to provide new multimedia services. The technology and development function has written a specification for this that it reckons will have a discounted cost of €500m. The sales and marketing function has estimated that offering multimedia services could generate discounted revenues of €650m if P offers all the extra services currently under discussion and takes these to the new countries where the board is seeking partners.

The development of information systems has been overseen until now by a steering committee supported by a project team. The members of the committee and team have been drawn mainly from the technology and development function.

You are required to:

(a) Recommend to P's board the controls that should apply to the process of appraising the proposed investment in new systems, technology and quality control.

(b) Advise the board on how the control systems may need to develop if P pursues the proposed opportunities.

P3 further reading

P Collier, *The Official CIMA Learning System – Performance Strategy*, CIMA Publishing, 2009.

R Brealey, and S Myers, *Principles of Corporate Finance* (ninth edition), McGraw-Hill International, 2009.

A Crane and D Matten, *Business Ethics* (second edition), Oxford University Press, 2006.