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Newsletter

He Who Laughs Last

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In "Harvard Business Review", Peter F. Drucker has observed that *"Bean counters do not enjoy a good press these days. They are blamed for all the ills of US manufacturing. But the bean counters will have the last laugh"*. (I would add "if they are willing to break from some, if not many, of their existing practices".)

My own assessment is that accountants are probably the most underutilised and misused professionals in business today. As I move amongst my client companies, I am continually confronted by accountants expressing frustration at seeing that they could do so much more. They see clearly that many current accounting/business practices are preventing profit improvement, not causing it. They are aware of their ability to help the operational side of the business as professionals; able to integrate accounting with business strategy and operating philosophy

However, as Drucker indicates things can be changed, and if they are, the accounting profession may still have the best laugh.

There are two hurdles to negotiate. The first hurdle is knowledge, and the second is the ability of the profession to conduct a deep self assessment, to remove poor theory and practice, and then build new integrated systems. If you prefer, these hurdles are "knowing what to do" and "the will to do it".

Knowing What To Do

This element has many facets, but for our purposes here, three principal elements are: understanding the unknown and unknowable (and un-measurable);

understanding systems theory, and understanding variation.

Variation

Despite the fact that both modern accounting and statistical theory stress the importance of separating random from non-random variation, and that both require practices such as using variance from budget/target as a measure of performance to be abandoned, little evidence of change to more modern methods is apparent.

Several better techniques exist that prevent monthly over-reaction and encourage a longer term focus on operating philosophy and strategic goals. One such method is to use a control chart for financial data. Those companies that have used these techniques have reaped significant benefits. After using this technique to understand and then reduce the variation in their cash position, one company reduced the cost of cash (in NSW alone) by about \$280,000 per year. The entire project took about one month to complete, and was conducted almost exclusively by the financial people.

This result was achieved by the accountants in one state, and in one division. As one extrapolates the results across all states and divisions, the cost savings grow rapidly.

The people we are competing with, particularly the Japanese, have been using these methods for years. They are techniques developed by an American, Dr W. A. Shewhart and introduced to Japan by another American, Dr W. E. Deming. As Drucker notes, the techniques were originally used for manufacturing but the social and strategic implications are, in fact, far

more significant. Some schools are now teaching more modern methods to undergraduate and postgraduate accountants, and these graduates are struggling to apply this new knowledge in an environment where adherence to older approaches is necessary for recognition and advancement.

As a director of The Delaware Group, a publishing and book distribution business, I need to know not only what the results have been, but also where they are going. My fellow director and general manager, David Boocock sends me a monthly financial report that has all the key financial indicators displayed as control charts. They allow us to know when to react and take action, and when to relax. We are able to predict our financial performance with a very high degree of reliability. We are able to be proactive rather than reactive.

Systems Theory

Modern theory requires better approaches to measuring financial contribution and indicating accountability than plant/branch/division profitability. In particular, measuring local profitability (as a performance indicator) on the basis of transfer pricing needs urgent review and replacement.

Most accountants understand the interdependence of the varying business units; how a cost saving at one unit can cause an explosion of costs downstream, for example. However, most work in companies where the accounting machinery can do nothing else. Other approaches exist. Modern theory has supplied new tools but how many accountants even know they exist? Accounting systems of the future will track performance of processes, both manufacturing and service; that flow horizontally through the organisation. The days when results are expressed solely on a department branch (etc.) basis are numbered.

Unknown and Unknowable

The most important business data are unknowable; unmeasurable. How does one put a cost or value on customer satisfaction, on morale, on training; on adherence to a long term strategy? Whilst effective financial measures are not possible here, the financial system can be integrated into the business systems to ensure that managers maintain a balance between financial measures and longer term strategic goals and adhere to the operating philosophy. This is the integration Druker hints at.

When Mr. S. Cray left Control Data, it is a safe bet that the financial reports did not indicate that a few years later Control Data, then the only producer of super-computers in the world, would not even be in the business. How do we measure the financial impact of a Mr S. Cray?

The Will To Do It

Among many accountants, the will to change; to build new integrated financial and business systems, already exists. They need only the tools and techniques, and the knowledge to use them. Others will stick to well-known and familiar methods. In the end, the laws of natural selection, which are every bit as effective in business as they are in nature, will do the job for us. In fact, they already are. For me, this self cleansing and self regulating effect of natural selection is the most endearing feature of the competitive marketplace. It's a little like gravity. It's cheap, dependable and utterly ruthless.

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