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In Focus: Planning in rapidly changing environment

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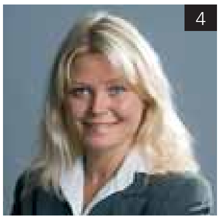

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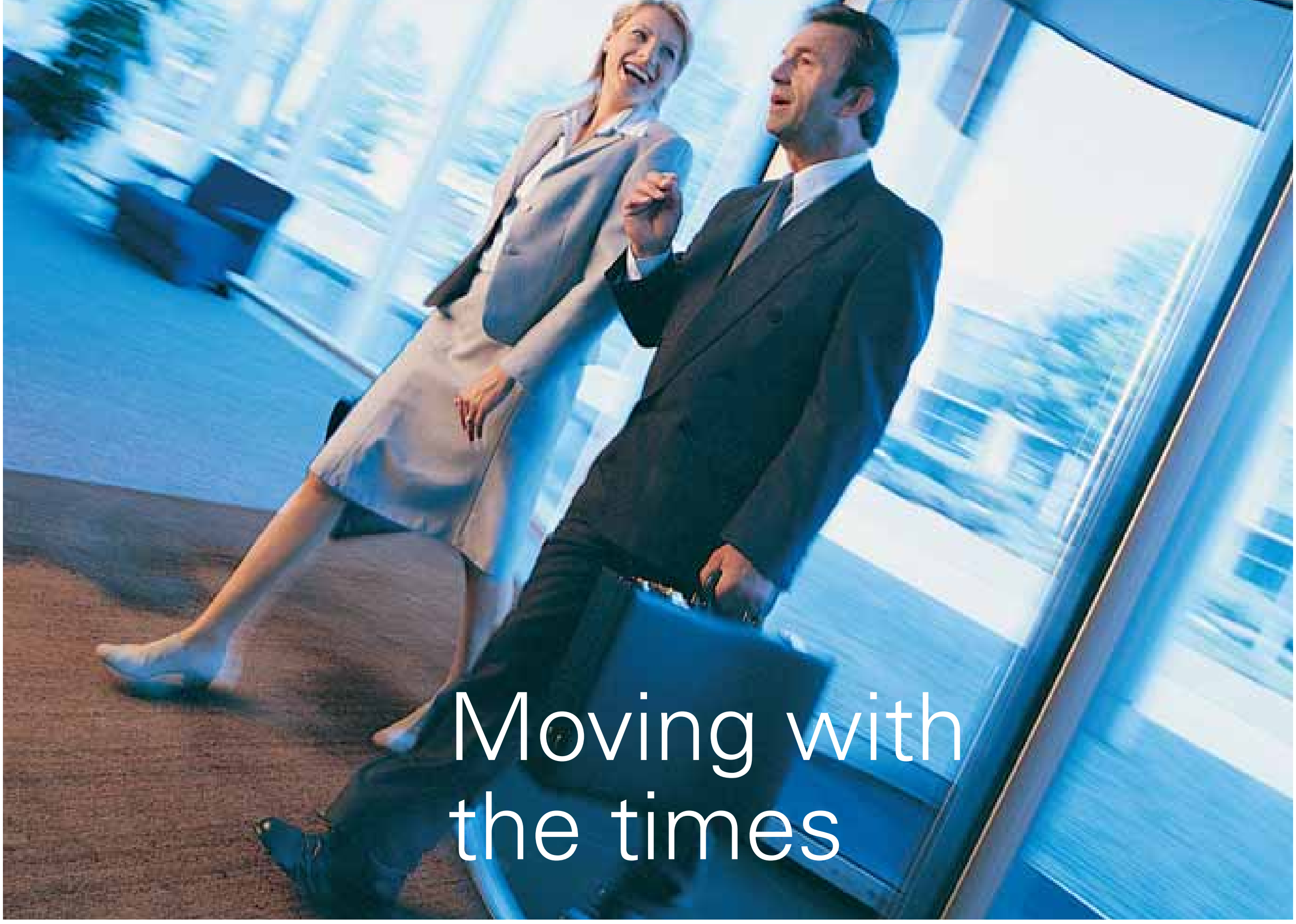
Successful companies are like top sportspeople who have to adjust their strategies constantly and rapidly when their rivals' action calls.

It is easy to understand and appreciate benefits if these are visible as process automation - for example elimination of double work - but it is harder to assess benefits if some kind of improvements are made, for example, to the reporting system.



Moving with the times

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A constant in this world is change and never has this been truer than in the Baltic business world today. Just as local economies are gearing up for tough anti-inflationary measures, turmoil in the world's financial markets has increased the prospect of difficult times ahead.

The theme of this issue, "Planning in a rapidly changing environment," is particularly current. Companies must chart their own course through turbulent waters or conditions or competitors will impose their own plans, argues Triin Tiedemann, advisor in Internal Audit Services. In other words, enterprises must plan for more than one development scenario and set realistic objectives.

Financial advisors Gints Bukovskis and Rainers Vilans look at how Latvian companies can minimise the effects of worker migration and increasing labour and materials costs on output. Business Risk advisor Kirils Maksimovics stresses the importance of budgeting in inflationary times. Companies can get ahead by developing their employees' strategic thinking, writes Business Strategy advisor Juri Sakkeus, and Management Advisor Mait Raava sets out the options for companies faced with external shocks such as stock or real estate market crashes. But not all change is externally driven, and Business Risk advisor Alexander Kochetkov looks at the effect of IT systems and communications problems in mergers. Finally, IT advisor Girts Kronbergs reports on how Latvian corporate leaders weigh up the pros and cons of IT investment.

We hope you will enjoy this issue of Forum and find it useful. We always appreciate feedback as we seek to make these productions relevant to our market. We look forward to hearing form you.●

Action planning – easy. Results planning – a real challenge.

"In preparing for a battle, I have always found that plans are useless but planning is indispensable." (Dwight David Eisenhower)

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Most of us probably agree with Mr. Eisenhower's opinion either fully or at least to some extent. Planning – well known as the primary function of management according to management theory – would be quite easy if the world in which we made our plans today remained the same also at the time of carrying them out. Various social, economic, political and technological factors influence the business environment of an enterprise, and positive or negative changes in those factors can work for or against our plans. However, predicting when, why and how one or another driving force surfaces and what impact it can have on us, is extremely complicated. Thomas Alva Edison summarised successful planning as follows: "Good fortune is what happens when opportunity meets with planning."

Hence, when preparing for the future, it would be practical to involve key persons from all operating areas of an enterprise who are able to foresee potential development scenarios as well as set realistic objectives.

If you do not make plans yourself, you will involuntarily become a part of someone else's plan.
Today, enterprises are operating in conditions where changes in the business environment are so fast that action planning which is based on outdated data can result in total failure. Due to rapidly developing technology and economy, making future predictions based on the past is a thankless proposition. Therefore, applying scenario-based planning is considered increasingly when setting objectives and developing strategies as it may enable an organisation to remain on track regardless of economic and technological upheavals. No doubt, coping with vagaries and being prepared for various situations provide competitive advantages that sometimes enable one to turn the pitfalls of the business environment into opportunities. However, despite a well-designed plan, setbacks and failures often occur during the implementation of plans. Failure emerges because, despite success in the planning phase, the whole organisation is pushing towards a triumphant finish aiming

at the agreed objective. They forget that the initially-agreed plan only accommodates one possible scenario, and fail to consider that the real life has meanwhile reshuffled the deck of cards.

During the plan's implementation phase, one must adjust their objectives in accordance with reduced indeterminacy and choose a new operating scenario according to the situation that has arisen.

"A good hockey player plays where the puck is. A great hockey player plays where the puck is going to be." (Wayne Gretzky)

The rate at which significant events are identified, and the so-called ability to catch the trend can offer a remarkable competitive advantage to an organisation. Systematic information about the objectives as well as the validity of the initially-chosen scenario should reach key persons promptly. The existence of the management's information channels and effective communication play a major role in this situation. Therefore, during the planning stage it should be agreed in an enterprise who is going to monitor the scenario the real world is following and, if necessary, inform of the need to adjust organisational goals. Vaguely allocated responsibility for such a process among employees can result in inactivity, as it seems that everyone is responsible for managing the information, and, at the same time, no one is directly responsible for it.

Never assume the number of people on your payroll equals the number of people working for you. (Lyle Sussman, paraphrased)

If you do not make plans yourself, you will involuntarily become a part of someone else's plan.

You cannot assume that employees will adopt management's objectives implicitly and that in the event of management's failures the rest of the organisation is willing to react as a "rescue team".

An organisation should be sufficiently aware of the agreed objectives and thoroughly-planned scenarios, and all key persons should accept those objectives and scenarios.

If employees cannot see the motives behind the objectives set by their management nor comprehend the implications of different scenarios, they are not capable of taking or feeling responsibility. In that case, in order to avoid feelings of aimlessness and confusion employees replace the qualitative objectives set by the management, which, however, have remained vague due to insufficient communication, with simple and clear quantitative objectives.

A motivation system based on performance fees works in an employer's favour as long as it is in line with their objectives and the chosen scenario. If adjusting the scenario calls for re-evaluation of the objectives but communication is not adequate, the motivation system may start working against the employer.

If an organisation has adopted the objectives and thoroughly-planned scenarios set by its management, staff are able to make the right choices and move in the direction the management has planned. Furthermore, it is far more likely that, should scenarios change, the organisation is disposed to react in an amenable, constructive and prompt way also to events which could not have been foreseen when drafting plans. •

Curbing expenditure requires a new approach

At a time when the Latvian economy is subject to rapid increases in prices and costs, companies are being forced to seek ways of reducing the negative impact of inflation on their output. This article will outline some options for combating the most difficult problems – the migration of workers, rising labour costs and increasing raw material costs.

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A survey of the Latvian economy carried out by the Baltic International Centre for Economic and Political Studies (BICEPS) names economic overheating as the main cause of inflation in Latvia and the other Baltic States, caused in the most part by the credit boom, increasing demand for labour and the resulting increase in salaries, the community's expectation of inflation, the exchange rate effect, and the changes to the Latvian economy arising from the accession of the new members of the European Union. Nevertheless, there is still some hope that the Latvian economy can avoid following a negative economic trajectory.

The main risks in Latvia's business environment

The main problem facing Latvian companies is ever-increasing purchasing costs – for raw materials, labour, energy resources, etc. Under inflationary conditions, it is very hard to control increases in costs which, in turn, makes long-term planning almost impossible. Given that the majority of Latvian companies are service providers, the increase in labour costs is particularly painful. The BICEPS survey also shows that our companies have to contend with an inflationary lag. That is, that the root cause of the current increase in inflation is the effect of salary increases in 2005. This implies that the impact of current salary increases will only reveal itself after a period of 12-15 months.

If we try to define those groups of companies who find themselves most "under the gun", we could say they are small- and medium-sized companies on the one hand, and exporters on the other. Small companies are capitalised at lower levels and, consequently, do not have the resources to enable them, in the face of rising costs, to delay or vary price increases on their products. These companies have to react quickly to all changes in purchasing costs and, as a consequence, they

can lose out on the competitiveness front. As a result of the small volumes of raw materials these companies purchase, they cannot use bargaining power to lever suppliers into offering better terms.
Exporters too, even if they are considered large companies by Latvian standards, find business tougher in inflationary periods. If raw materials are purchased in Latvia they are affected by inflation. But export goods have to compete with products from other countries with completely different economic conditions.
Latvian companies, because of their limited production volumes, cannot dictate prices in export markets, and consequently their ability to transfer increased production costs onto the price of finished goods is restricted.

Given that the majority of Latvian companies are service providers, the increase in labour costs is particularly painful.

Current expectations
A number of the factors which have contributed to the development of inflation in Latvia have recently begun to decrease. This raises the hope that the Latvian economy may not suffer a hard landing after all, something that could determine the fate of many local companies.
For example, banks, becoming more conservative and allocating less funding to consumer credit, could alter the inflation-development curve. Moreover, the old adage regarding loans to companies remains valid: if companies have good business plans and practices, they will not find it hard to obtain credit.
Another factor which could reduce the pace of inflation is the resolve of the governing coalition to adopt a non-deficit budget. Governments to date have, overall, met supplementary financing needs and, ignoring the rapid development of the Latvian economy, lived on borrowings. The experience of Estonian governments has been the opposite and a stable non-deficit budget has been achieved for a significant period.
Companies' problems may also be alleviated by the fact that, in parallel with the salary increases of recent years, the flow of labour overseas has decreased. Comparing salaries and the cost of living, working in Latvia is becoming more attractive.

Supplementary bonuses for attracting employees
Today, the most severe problems faced by the majority of Latvian companies are to do with their labour force. If managers do not increase salaries, it is more than likely that they will lose valuable employees. This problem can be resolved by a number of approaches, depending on both the State and companies themselves.
Recently, the option of importing foreign labour has been discussed more and more. This option would be beneficial to those companies suffering from a shortage of unskilled

labour. Nevertheless, the long-term consequences of such a decision have not been fully evaluated.

Companies can themselves take action by offering employees additional incentives for staying.

One of the options we would suggest considering is so-called share-based payment, or offering company shares or share options as a form of payment. Schemes under which companies' employees are allocated company shares or entitlements to acquire shares are quite widespread around the world - most of the world's major companies work in this way and the first examples are beginning to appear in Latvia.
Firstly, this scheme allows companies to attract the best employees, because now they are working for their own benefit. Secondly, companies can offer significant supplementary bonuses, without increasing expenditure and, in consequence, their operating cash flow. In turn, employees benefit from dividends which are paid to shareholders, as well as from the revenue resulting from the selling of their shares. It is generally accepted though, that this type of remuneration scheme is more appropriate for maintaining the motivation of managerial staff.
The type of remuneration scheme referred to has its own specifics which are described in International Financial Reporting Standard No 2, Share-based payment. Also, disappointingly, the application of this practice is being held back by the lack of appropriate taxation legislation.

Companies can themselves take action by offering employees additional incentives for staying.

Long-term obligations and the search for alternatives

In turn, to restrict the impact of inflation on raw material prices, it is worth considering concluding long-term, fixed-price supply contracts. However, this approach has its own risks. If inflation continues for the next few years, those companies that conclude long-term contracts will have won. If, however, prices begin to fall, long-term, fixed-price contracts may prove disadvantageous.
Businesses have to research the options of obtaining the raw materials they need in alternative markets. Success would enable prices to be held in check, impacting both competitiveness and profit margins. •

Budget monitoring helps companies focus on the road ahead

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Relatively rapid price increases have been a reality for Latvia's economy over recent years – labour costs, raw materials and administratively-regulated prices have all gone up. These trends affect virtually all local companies, meaning that frequently their operations become like a journey in the dark when no one is sure what lies a few steps ahead. However, properly preparing a budget and its careful nurturing to fulfilment can help shed some light on the situation.

A year-long journey

When a company prepares its budget, it is important that it clearly sets out its development goals. Furthermore, under conditions of rapid price rises it is important to carefully monitor the economy's effects upon the business process in order to be aware of any "stumbling blocks" which can adversely affect the budget, and to make decisions on how to avoid these. The budget sets out a path for the next planning period with 12 marker flags which allow us to make sure on a monthly basis that we have not wandered off the path leading towards our objective.

When setting a budget in the

economic conditions currently prevailing in Latvia, a company's first task is to define its profit target and how to achieve it, i.e. this must be the top priority for setting the budget. Flexibility of change must be built into the other reference points for the budget – turnover and costs– in order to achieve the profit target. Every company faces a different situation, so there will never be two identical approaches. However, the basic principles are clear: if prices for materials increase and the initial profit target must be maintained, either turnover will have to increase or the company will have to work more efficiently. The necessity for such changes must be noticed in due time and the appropriate decisions must consequently be made.
Company management must have a clear vision about development, and every employee must clearly understand the tasks they have to perform to reach this objective. Seen from this angle, the fulfilment of the budget becomes simpler, even when prices are on the rise.

The four pillars of budget fulfilment

It is important to remember the four main principles of budget fulfilment. Firstly, every employee of the company is responsible for the fulfilment of the budget. The budget and its fulfilment are not just the concern of the company's management or finance department. Behind the budget figures are goods, services and employees. Therefore, company management must be able to "materialise" these financial numbers between units and divide the tasks of budget fulfilment between all employees so that each of them has a clear understanding of what must be done and is able to contribute to budget fulfilment.
The next principle to remember is communication. Company employees must be informed in due time about changes and possible problems in their sphere of work. Information exchange and alignment of decision making are required to ensure successful operations in rapidly changing conditions. In this case, company management can be compared to a person who is using one hand for production and the other for sales. If there is no head between these hands to coordinate their actions, there will be only problems.

Running a company without forecasting is like driving a car while staring in the rear view mirror.

For example, if production costs rise, someone must decide how much sales must increase, and the sales team must be informed of this.
The third principle is structured management. Budget management cannot be left to take care of itself, and the organisation must have a system for gathering and analysing information about the company's activities and for making decisions. Having such a functioning system is a precondition for adequate monitoring of budget fulfilment.
The fourth factor to remember is planning or forecasting. Many economic theorists have compared running a company without forecasting to driving a car while looking in the rear view mirror. By only staring at the fulfilment of the budget, we can see where we have been but we are not looking ahead. Furthermore, forecasting the near future does not mean having to hire scientists or looking at tea leaves; all that is required is talking to your best employees. For example, the company's sales specialists are fully aware of seasonal sales trends, customer moods, and changes in these aspects. All the information required is within your company; all you have to do is to gather it and use it correctly.

Forecasting turns on the lights

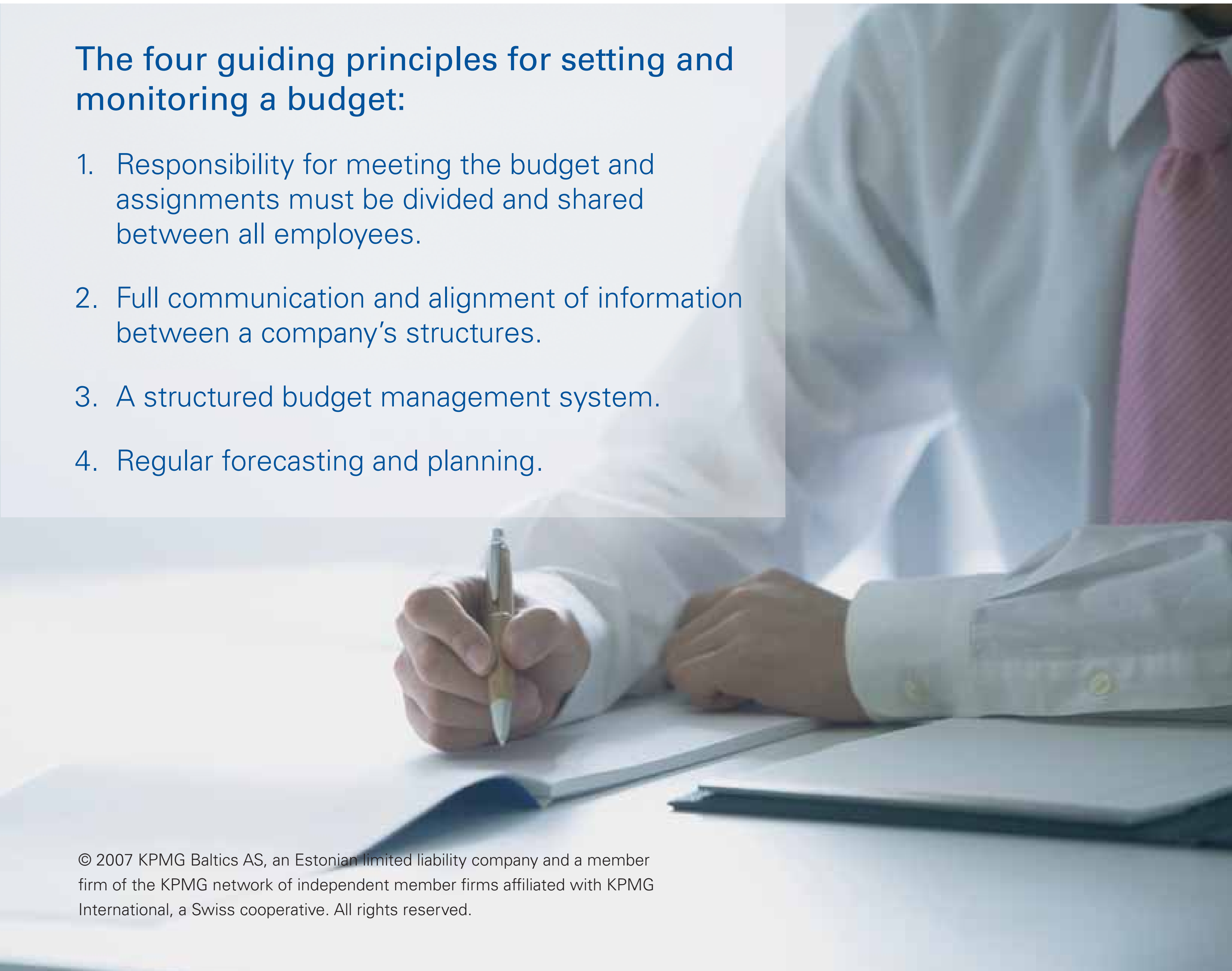
All of the aforementioned principles must be observed in setting a budget and monitoring its fulfilment. However, in some circumstances the level of their importance changes. Forecasting and planning assume much greater significance during periods of rapid price increases. Furthermore, short term planning is vital, for a month or two or even just a fortnight ahead. By analysing the market situation and forecasting its development in the near future, it is much easier to decide what the next step should be.
This process can be compared to driving a car at night. It is possible to drive without the headlights on, and you might even get a long way if the road is straight. However, inflation and an unstable economic situation put curves in the road, making fast driving possible only with the lights on. For companies, the headlights are forecasting and planning. Although situations may differ, forecasting follows a set logic. Firstly, a company must anticipate potential sales volumes. Secondly, it must anticipate changes to costs. These two factors give a clear picture of what action must be taken if the company is to reach its profit target.

If it is clear that there will be problems in the future, an appropriate decision must be taken to raise prices, introduce new products, reduce costs or increase efficiency.

The second principle, which is becoming increasingly important, is communication. Its significance can be grasped by comparing the situation with so-called "peacetime" conditions when prices are stable and inflation is under 3 percent. For example, if a company wants to make LVL 1,000 profit and its production costs are LVL 9,000, the produced goods must be sold for not less than LVL 10,000. The task of both the producer and the sales team is clear, and they just have to carry it out. On the other hand, when prices for materials and labour are rising, the production situation can change rapidly. The sales team must immediately be informed of this and decisions on further action must be taken, because only thus can the company hope to achieve its anticipated profit.

In conclusion, I would like to stress that a budget cannot always be fulfilled in the way that was initially planned. However, the main point is to be aware of your objective and to not be afraid to change in line with the present situation. •

Inflation and a less stable economic situation make the road a twisting, turning road, making fast driving possible only with the lights on. For companies, the headlights are forecasting and planning.



The four guiding principles for setting and monitoring a budget:

1. Responsibility for meeting the budget and assignments must be divided and shared between all employees.
2. Full communication and alignment of information between a company's structures.
3. A structured budget management system.
4. Regular forecasting and planning.

Strategic planning using workshops

According to today's conventional wisdom, there is only one means of achieving a permanent competitive advantage: It is an organisation's ability to learn, change, and be prepared to react to the hazards and opportunities of the business environment duly and properly. Business leaders must realize what those "new right things" that bring future success are before their competitors do it. While this may sound easy, how can it be managed in practice?

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One way is to develop employees' strategic thinking abilities by involving them in devising and implementing strategies.

All the key persons of an enterprise, i.e. those who are primarily in charge of carrying out any plans and initiatives, should be involved.

Strategy work is done via a systematically-prepared series of workshops where appropriate methods are applied and where discussions lead to shared concepts in such central questions as, for example:

- What is the business like we are involved in today? What are our advantages and disadvantages?
- What are the main success factors in our business area and how can we differentiate from our competitors?
- Which factors are changing? What trends can we identify and how can we monitor those trends? How can we recognise our opportunities? How will those trends affect our business in future?
- How are the competition and clients' preferences developing?
- What is our vision like, i.e. how do we imagine the future of our organisation?
- Should we grow, and how should we do it?
- What are our directions and initiatives when pursuing our vision?
- What skills do we need in future?
- How can we retain and find talented employees?
- How can we measure our success?

Strategy work is done via a systematically-prepared series of workshops.

Strategy workshops can also be considered as a learning process. As a rule, external specialists are involved, strategy-related lectures are attended, and examples from other enterprises and industries are studied.
Quite often, an adviser with knowledge as well as experience from previous projects is asked to lead the process and impart the methods.
As a result of such workshops:

- A strategic plan and action programme for the subsequent period (usually for a year) is devised
- The strategy is "sold" as people who are going to implement the strategy participated in the devising process when everyone had a chance to listen to others and express their own opinions
- An organisation is more prepared to react to opportunities and hazards
- People are working as a team moving in one direction.

Strategy workshops should not consist of just one single event. According to best practice, the team meets, for example, once every three months to evaluate the implementation of strategic projects and, if necessary, adjust the strategy. At least once a year, they thoroughly re-assess the business environment, including an evaluation of the strategy's validity.
The strategy devised in this way is active and adaptable, and it is well defined in employees' minds who are carrying it out day-to-day. The organisation is now healthy, well prepared, and ready for the competition. •

Strategic planning in a turbulent environment: vision and the vision-based scorecard

Management adviser Mait Raava admits that when the surrounding environment is turbulent and unanticipated changes occur that may have either a positive or negative impact on companies, setting high targets would be advisable. However, on a business unit level, professional teams might set their own objectives and accomplish them.

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Pro Konsultatsioonid OÜ

What does 'the future is turbulent' mean?
In economics, we can say that the situation is turbulent when you cannot predict how the market is developing over a period of 1-2 years. One typical example could be over-valued stock or real estate markets that may either collapse overnight or continue their climb for a long time. The economic and political sanctions from Russia that followed the April riots in Estonia provide the most recent example of such a situation. Those sanctions may either rapidly ease off or deepen and broaden unexpectedly. Another example is mergers of leading companies that result in stifling small companies with competitive advantage in price and quality.

What should the leader of an enterprise do in a turbulent situation?
One option is to take the risk and set about reducing the turbulence on the market by buying up smaller companies in order to gain more influence on the market. Eesti Ühispank was successful in doing so at the beginning of 1990s, as well as Hansapank which swallowed up another Estonian bank, Hoiupank. The risk of such a strategy, however, is that you may cede your position to global corporations when they decide to enter the market. This is what happened to larger Estonian banks in 1998, after the 1997 stock market crash that also resulted in the winding up of several smaller banks in Estonia. Another option is to spread risks by diversifying your product portfolio, but you should be prepared to write off losses in the event of adverse market movements. The activities of some Estonian companies at the turn of the millennium serve as examples of such a strategy, e.g. Microlink (an IT, internet, consultation, and media company) and Kalev (chocolate and milk factory, real estate, media

and event marketing group). When following this strategy, allocating risks to involved partners is highly advisable. A number of western companies have done so in Russia. The third option is specialisation in order to grant oneself the best competence in the field within the region or even globally. Thanks to top experts, a specialised company is able to learn and adjust to market changes much faster than its competitors. Such Estonian companies as Regio, Proekspert, MarkIT, etc. provide remarkable examples of applying that strategy. Since competition is increasing, the probability for earning profits is highest when following the third strategy.

What makes strategic planning different when in a turbulent situation?

Fast action is most critical here. Winners are those who act fast and learn fast during the process.

Successful companies are like top sportspeople who have to adjust their strategies constantly and rapidly when their rivals' action calls.

In a volatile market situation, those companies will survive whose employees are more experienced and faster than their competitors', and who devise their strategies in the course of action, i.e. they think and behave as strategists. Under such market circumstances, it may prove impossible to draft a strategic plan for 3-5 years. That, in its turn, does not allow employees with less experience to advance gradually when working in a company: they must be professional in the here and now. Figuratively speaking, successful companies are like top sportsmen who have to adjust their strategies constantly and rapidly when their rivals' action calls for it. A company operating in a stable market with a vision of 3-5 years, e.g. the energy market, can afford the luxury of employing strategists and others who carry those strategies out. Such a company operates relatively slowly, like a leisure sportsman.

In turbulent times, do companies give up strategising completely?

No, they do not. They write concise, A4-size strategies, based on their 5-10 year visions that explain a company's specific financial objective and provide a short description of its business model. The strategy is drafted on a quarter or half a page. A scorecard for a period of 1-3 years, which contains critical success factors and plans for how to achieve those factors, is also designed. The plans are adjusted flexibly throughout the operation. In effect, this means that we envision a business model and adapt that model during its implementation.

Another significant distinction from traditional planning is that in a turbulent environment, scorecards do not map out how to develop people but how to find and motivate the right ones. The risks related to investing in staff development would be too high.

What must a professional have?

The first requirement is extensive experience. What you learn at school, is one thing; experience gained from work is something quite different. The next necessity is the ability to see the big picture. Actually, this means "thinking outside of the box" – a creative approach. The third must is the ability to learn quickly, the fourth the courage to take risks and endure stress. The fifth requirement is the ability to influence others.

What must a leader have?

The same as other professionals, but they should also be able to ensure that information is shared, as the speed and quality of information are of critical importance. In order to achieve all that, a leader should be able to create the right organisational culture and form a team, recruit the right people, and identify professionals. The third important factor is allocating roles to the right people. Lastly, in order to motivate people, a leader should acknowledge and reward them.

What are the typical errors included in strategies drafted in turbulent times?

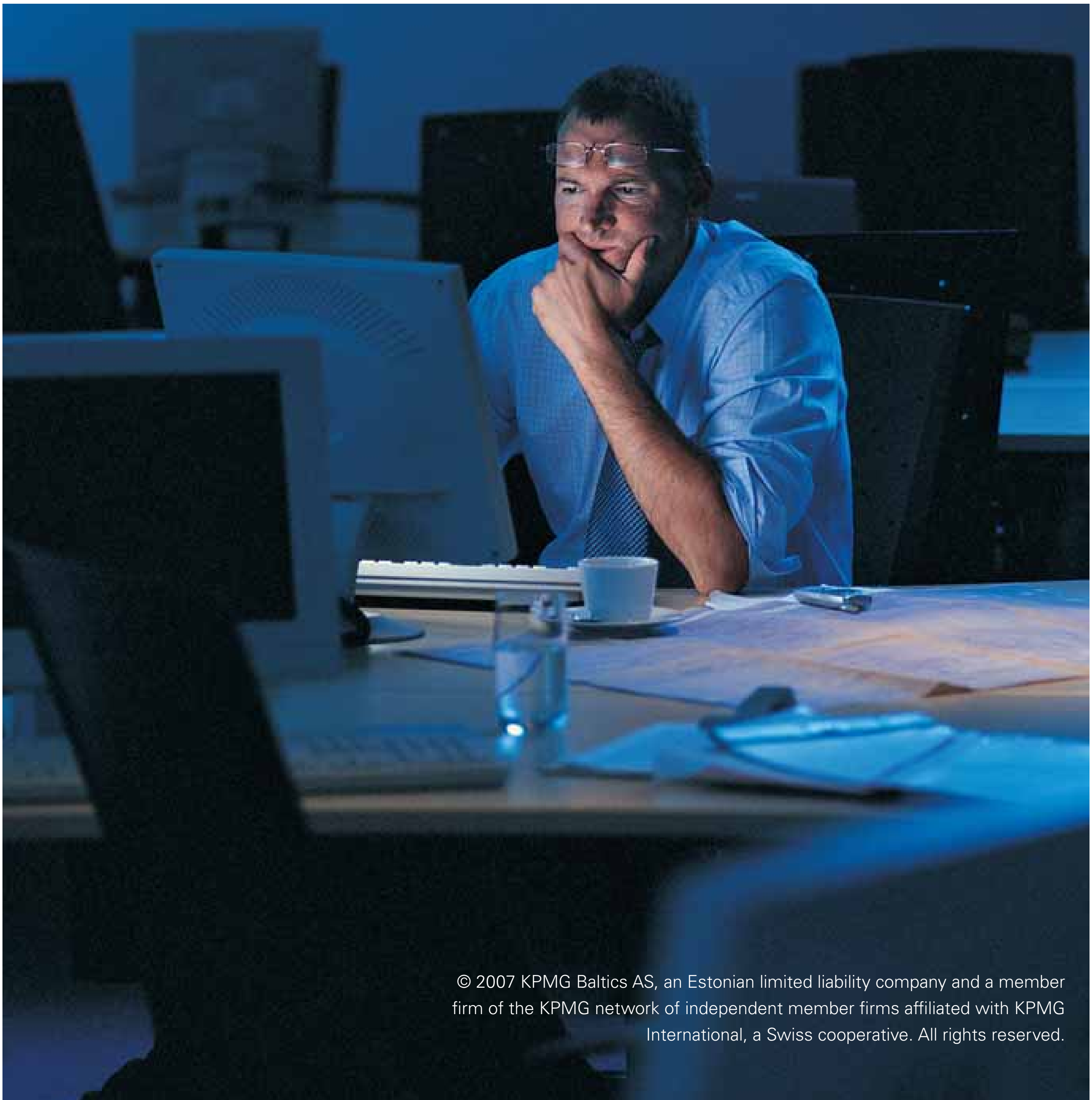
One common error is devising long-term strategies, i.e. "writing into a drawer". In fact, this can be good if compiling such a strategy document is not taken seriously but supervised by chains of command. In this way, at least total chaos can be avoided. Such supervision can be a big burden for busy top executives.

Another common error is drafting strategies for individual divisions without considering the organisation's overall vision. As a result, neither the divisions nor management know what kind of synergy the divisions create nor what the strategic information (market feedback) is. This situation causes inefficient utilisation of both, resources and employees, in its turn.

The third error is the lack of strategic indicators that results from the erroneous opinion that, since there is no point in making plans in a volatile market situation, financial statements will do. However, this is a fatal mistake because a company cannot control activities bearing success without such indicators. In order to be able to manage success factors, they should be measured so that the management can intervene as soon and as decisively as possible.

To sum up, what would you tell a leader who wants to be successful on a turbulent market?
First, a leader should understand that only a well-orchestrated and co-operatively operating professional team can achieve success on that market. Professionals act more efficiently and faster than their competitors do. In such companies, divisions draft their own 1-3 year strategies (read: scorecards) based on the company's vision and adjust their strategies flexibly and independently. In conclusion, we may say that under comparatively predictable market conditions, owners invest in "the right products", whereas on an extremely turbulent market owners invest in "teams of professionals". In the former case, the owners want to see thorough and extensive documentation related to the company's strategy, while in the latter case they are concerned about the scorecards of their professional teams.

Are increasingly unpredictable markets the reason why we keep talking about winning over and retaining talented people?
Yes, they are. The world is changing faster, and so the big money is going to teams of professionals, i.e. to those whose action is based on both a vision and scorecard. •



An effective merger: 10 things to remember (continued) and how IT planning can help

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The precursor (see Forum, Spring 2007) to this article emphasised the importance of 'vision' in the merger process. As you may also remember there are two other important issues such as Operations (Business processes) and Technology (IT systems and communication). Leaving business processes for later, this piece covers IT systems and communications issues.

The IT side is usually considered least important in the merger and acquisition process. How many of you or your managers are familiar with corporate IT strategy? How many of you have reviewed the IT strategy of the company you are taking over? Do you actually have an IT strategy? Do you know what ERP system version your company is using? IT departments are commonly treated only as cost generators, and IT managers receive little support from management on their decisions. There are a number of reasons for that. One of them is that IT strategies are not aligned with corporate strategy. Ask yourself the question, "would I hire a new accountant if my plan is to outsource the accounting function to a third party?" Probably not. It is time for the management to look at IT from a different angle. IT is no longer playing just a supportive role. As technology develops IT and communication become an ever more important core business process. In many cases Outlook serves as the corporate communication channel. It is also hard to find the company that does not have its own Intranet or does not use some kind of ERP or accounting system at the very least. In the merger process IT must be considered as any other core business process.

An IT strategy has to be in place, existing IT systems have to be reviewed and a new corporate IT

strategy must be created before making any changes to the existing IT landscape. Different tools can be used here. McFarlan and McKenney's *Strategic Grid Model*, the *Generic Strategy Analysis* of Michael Porter and Porter and Miller's *Information Intensity Matrix* are the most common.
A SWOT analysis of the current systems must be performed and Return on Investment (ROI) and Total Cost of Ownership (TCO) have also to be calculated. It is very important to have a grasp on how much it will cost to integrate the existing systems. Maybe it is even better to replace one of the systems and minimise the integration and/or maintenance costs of the other.

Approach is another important issue to remember. Information systems can be classified into three broad categories:

- Legacy systems
- ERP systems
- Extended ERP systems.

Legacy systems are largely functional in their approach. One of the specific advantages of legacy systems is the fact that they enable specific functionalities. Since legacy systems are built for the function alone, the efficiency of the system with regard to automation and information is very high. They can thus be a source of strength. The company, in this case, possesses a well-aligned system with its strategy. The transformation aspect of legacy systems is less than other ISs. There is a tendency to increase the inertia of the organisation when it comes to change management. Legacy systems are thus typically the inimitable strengths of many organizations. However, this is not always the case.

Legacy systems are thus typically the inimitable strengths of many organizations.

ERP systems, on the other hand, are more integrative in nature. Most ERP systems are not custom built due to the prohibitive price of the system. And hence ERP solutions are normally bought off the shelf. ERP systems are also required to improve cross-functional information flows. However, implementation of the system involves (normally) a little bit of customisation and an alignment of operations in tune with best practices. This could also result in considerable deviation from existing methods of operations as well as a compromise of synergy or of even competitive advantage (in case the 'best practices' are not well suited to the particular environment).
However, ERP systems must be formally strategised in order to get the best value over the long term.
Extended ERP systems are those in which the information network transcends the boundaries of the firm. These systems have a very complex information flow sequence. They are similar to the paradigms for networked organisations. Such a system possesses multiple implications in terms of the strategies

available for various functions, e.g. supplier integration. Thus, it is to be inherently linked to the strategies of more than one organisation.
Mergers itself are categorized as: Vertical merger, Horizontal merger and Conglomerate merger. In every merger case individual scenarios must be developed.

ERP systems. The most critical aspect in this case is the re-configuration cost. If the reconfiguration cost of the system is high, the companies might hesitate in opting for implementation. The functionality offered by the legacy system might be far superior to those of the ERP (due to the strategic nature of the system). If

IT system integration during the merger process has to be treated with much higher importance than it has been until now.

From the IT perspective the most common situation in the Baltics is when legacy and ERP systems have to be integrated. This is mostly due to ERP systems not being that popular in all three Baltic States and historically a lot of programming has been done in-house. On the other hand, western companies often present on the buyer side largely use the ERP doesn't have adequate APIs (Advanced Programming Interfaces), a unified system might prove to be costly and might not even function. This would result in a compromise with few strengths (as a networked system can prevail over a fully integrated system). This is typically the case where the information intensity of the legacy system is much higher than that of the ERP system.
In summary, IT system integration during the merger process has to be treated with much higher importance than it has been until now. Three steps must be taken:
First, the IT strategy must be aligned with the corporate strategy. In some cases, the strategy of some third party has to be considered.
Second, the strengths and weaknesses of each IT system have to be carefully examined and documented.
Third, the best fit approach has to be developed based on the first two steps.
Lastly, if you don't feel comfortable with taking these three steps, seek professional advice. It can save you some time and money.
The next article in this series will review merger aspects at the Operational (business process) level.

How justified are investments in IT projects for a company's competitiveness?

A company that does not have access to information technologies to a certain extent is unimaginable today. In a number of sectors, modern IT solutions are business drivers for a company to compete in the market. However, when making investments in IT, owners and managers always face the question – how justified are they, what returns will they bring and how long will it take for the money spent on technologies to reflect on better operating results?

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KPMG invited members of the Latvian business community to discuss these issues at one of its "Business Breakfast" seminars.

Business case justification for projects

Before a company begins to evaluate the business case for an IT project, it is worth remembering that any IT project is based upon four main elements: costs, time, material (financial) return and non-material (risk reduction, employee satisfaction, patents, reputation, etc.) returns. Only through the consideration of these four elements and the managing their implementation, can a project be successfully completed. However, adherence to this is not always observed in practice. Most real IT project implementation examples show that usually only costs and time are evaluated and oversight of material returns, although planned, is very rarely performed in full. This means that the business case justification is usually done on paper before a project is started, but the business benefits to be obtained through the project's implementation during the project life cycle are not measured.
From the business case perspective, it should be considered that IT

projects can conditionally be divided into two groups: projects for which the business case justification can be calculated in terms of financial benefits to be gained if the project is successfully implemented, and projects for which such a calculation is more complicated. The first group includes those projects related to process automation or improvement, elimination of work duplication and IT solutions for creating and implementing new products. The second group includes projects that lead to a more qualitative information system and therefore to more qualitative decision making, improvements to the internal control system and general improvements to information security.

It is easy to understand and appreciate benefits if these are visible as process automation - for example elimination of double work - but it is harder to assess benefits if some kind of improvements are made, for example, to the reporting system.

Common understanding of the objective

Corporate leaders in Latvia agree that the main reason for implementing IT projects and investing in such projects is to meet a company's business objectives which arise from the company's strategy. As a result, IT strategy is an element of a company's overall business strategy, and IT projects and investments are subordinate to IT strategy. If a company lacks understanding about its IT strategy, i.e. how the company should look in 3-5 years in the IT area, then frequently the initial IT project is altered and adapted to IT development trends several times during the implementation period, sometimes resulting in the loss of the project's initially-defined objectives.

Project objectives: to measure or not?

Corporate leaders say that during the course of a project an evaluation must be made of the project's objectives and achievements so as to be able to change the objectives and benefits of the project or even suspend the project in time, if unsuccessful, before the project results in higher losses to the business. However, in practice this sort of consistent and ongoing measurement of a project's achievements is conducted relatively infrequently. On the contrary, funds for the project are often allocated once and spent regardless of the results achieved. The corporate leaders also agree that measurement of achievements should be conducted using common sense – it is more important to measure for complex projects or for projects which are not implemented in accordance with the plan or do not bring the desired benefits, than for relatively simple projects, where it is apparent the project is going according to plan.

New technologies and the myth of staff downsizing

One of the paradoxes relating to the introduction of new technologies is that a benefit is usually considered to be a reduction in the number of employees. In practice, this happens relatively infrequently and usually only in companies which have previously made little use of automation of technical processes. Experience shows that a large proportion of companies which are growing and developing implement systems to improve processes and controls within the company itself. After introducing a new information system or technologies, a demand is created for high-level specialists who maintain and are able to use such a system. Therefore, often the introduction of technologies means no significant change to staff numbers. In some cases, staff numbers or costs after implementation of a new system increase. It is also a mistake to believe that introducing a new IT automation solution will resolve all business problems. IT is a tool and an assistant which must be directed by someone in the right way to achieve the desired results.

To lead or follow?

Being a leader means investing in new products and solutions, and that means an investment in information technologies. Being a leader is always harder than implementing already well-known and tested IT solutions. However, being a leader also means improving your competitiveness and attracting new clients. This may later prove to be more difficult for competitors if the leader has well planned tactics for positioning the new product or solution. Being a leader means creating an aggressive business strategy.

Being a follower isn't so bad either, because implementing known and tested IT solutions usually requires a smaller investment: less time has to be spent on initial analysis and research, and mistakes made by others can be avoided. However, since known and tested solutions are already in use elsewhere, the richest pickings may already have been seized.

Companies must decide for themselves: in order to compete, a firm must find its position in the market between its competitors and reach an appropriate balance between innovation and tried and tested IT solutions. •

A coordinated objective usually fails unless everyone understands it in the same way.

In a dynamic environment

fast decisive action can make a huge difference.

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