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In Focus: Effectiveness – a leader's major challenge

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In essence alternative markets are securities trading platforms that have been tailor-made for the trading of SME shares.

Effectiveness – a leader's major challenge

"Don't manage – lead change before you have to." This issue of Forum looks at whether firms in the Baltics are taking these wise words from Jack Welch to heart.

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Together with my colleague Girts Vitolins, we look at how Latvian firms are dealing with effectiveness. We argue that organizations need to go back to school - success means being in continual learning mode. KPMG's Finland and Germany offices explore how firms are gaining competitiveness by going pan-European, while in a series of articles our colleagues in Estonia define what a Societas Europaea really is, how it works in practice, and what its tax implications are.

Effectiveness is an even bigger challenge when two organizations merge, so Alexander Kochetkov lists ten steps to making the marriage work. Liga Cubaka looks at how HR management efficiency audits can help get the best out of your most valuable resource – people.
And Jüri Sakkeus looks at the achievements of the man described by Fortune magazine as "Manager of the Century." Mr. Welch can certainly provide insights for companies in this exciting region. •

Effectiveness – an ongoing learning process for which perfection has no limits!

The world today has become exceedingly dynamic, with business success increasingly dependent on an organisation's ability to work both efficiently and effectively. While this concept may appear rather straightforward and uncomplicated, this article will look at issues relating to business effectiveness and how it applies to the business environment in the Baltics.

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We have observed situations where businesses are struggling to keep pace with an endlessly changing landscape: supermarket shelves not always stocked with the products one is looking for due to imperfect logistics and supply chain management, producers faced with additional costs and merely passing them on to consumers rather than seeking ways of improving manufacturing, and inferior management decision making because of delayed information. These are just a few of the problems businesses in the Baltics and elsewhere face today.

What is Effectiveness and how does it differ from Efficiency?
This is a classic subject that business leaders and academics have been debating forever. Efficiency roughly translates into doing things right, such as getting the most out of your resources, be they people, products or services. On the other hand, effectiveness means doing the right things, such as setting goals and objectives and then ensuring they are achieved.
Effectiveness is a recurring topic in corporate boardrooms, throughout all industries and organisational levels. While prescriptions for improving and managing organisational effectiveness are widely available, implementing them is where many companies encounter a real challenge.
In an increasingly competitive environment, innovative approaches and techniques that enhance business effectiveness play a vital role in sustaining the winning edge for companies. Those that have

discovered these techniques are viewed as learning organisations, capable of adapting to their changing environments and competitive landscape. Accordingly, corporate development and education are the mastery of thriving in a mode of continual learning.

Confronting global competition
Today's marketplace is characterised by more turbulence and uncertainty than in the past, owing to the rapid expansion of globalised industries. The challenges of working in today's dynamic business environment have increased significantly, requiring more resourceful means of staying competitive.
At the individual level, multitasking, reassessing priorities and contributing innovative ideas are essential skills in a changing environment and critical to personal success. Personal effectiveness plays a key role in the overall success of any business, where a company's achievements are exceedingly dependent on its investment in human capital. In some instances, this investment can total nearly 70% of an organisation's worth. While companies continue exploring new and enhanced approaches to implementing and delivering value, it is also essential that individual and collective effectiveness be properly aligned in order that they function in tandem.

Effectiveness can be quantified, as seen in some of the results from a 2006 survey conducted by the Institute of Internal Auditors*. A portion this survey measured elapsed time intervals of internal audit cycles by industry in various countries.

The total duration of an audit cycle from initial planning to the release of final reports ranges from:
- less than 60 days in the chemical and pharmaceutical industries
- over 80 days in the insurance industry
- over 90 days in educational institutions
- over 120 days in many public sector agencies.

Of significance is the indicator of elapsed time from the completion of fieldwork to final report approval, where indicators range from:
- 20 days in the oil industry
- 27 days in the retail sector
- 36 days in transportation and insurance
- 42 days in the educational sector
- 52 day in the public sector.

These statistics demonstrate varying trends by industry, but more importantly they show significant differences in the timing of data dissemination. This can represent a significant risk to an organisation's capability for sound decision making.

Corporate development and education mean being in a mode of continual learning to allow a company to thrive.

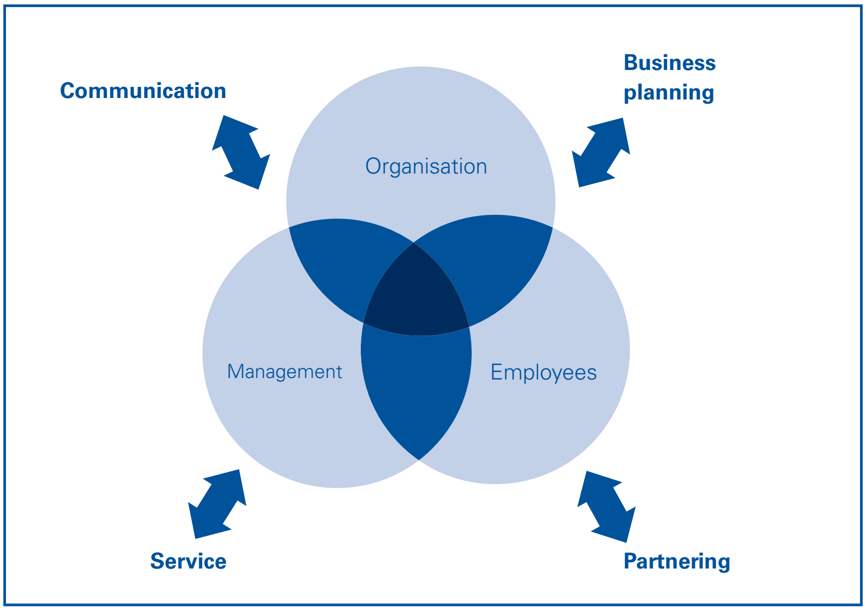
Latvia must continue to evolve and adapt
The business landscape today in Latvia is no exception. EU accession in May 2004 truly launched the country into the global arena, triggering both rapid economic change and energizing businesses to reassess their changing environment. In recent years, businesses have achieved lasting accomplishments by learning, adapting and thriving in a market economy. At the same time, coping with the throes of a nascent economy many of these businesses still face challenges in establishing more effective business methods, while dealing with continual change in their business environment. Today, both local and international companies are competing in the same markets, vying for incremental market share increases. Playing fields are shifting as companies begin turning to methods directed at developing competitive effectiveness. Company growth and market penetration has led to intense competition as businesses embark on reinventing their corporate strategies, realigning business models and developing more effective tactics to survive.
Several examples illustrate how companies in Latvia are beginning to explore new business approaches, including;
- distributors looking at ways of improving their logistics and supply chain management systems
- service providers focusing on ways to strengthen customer allegiance by expanding service portfolios and improving service quality
- wholesalers and retailers striving to expand their product lines and customise their offerings to meet consumer demand
- organisations evaluating and implementing internal control systems to improve both design and operational effectiveness.

What differentiates companies competing in the same market sector today, and how do they achieve leading market positions? And why are some companies able to thrive while others either stagnate or eventually become extinct?

**Source: www2.microwebs.kworld.kpmg.com*

The recipe for success is creating and managing effectiveness
Successful companies are those that have been able to break the mould of standardised, or historical, business practices, allowing them to take up entirely new ways of assessing and conducting their businesses.
Having the knowledge and skills to increase business effectiveness and overall productivity by employing proven strategies presents them with opportunities to improve their corporate effectiveness. However, corporate effectiveness must be appropriated through both corporate and competitive strategies.
External to the organisation, corporate strategies are concerned with other businesses the firm is engaged with, while competitive strategies relate to how relationships with these other firms are developed. In each case, an organisation's key measure of corporate success is its ability to add value to the resources it uses.
Within an organisation, effectiveness relates to the unique character of a firm's relationship with its suppliers, customers and employees, where each must be precisely identified and applied to their relevant markets.
An organisation's effectiveness is therefore determined by both internal and external factors. Internally, a business needs to address the organisation itself along with its management and employees. Externally, awareness is applied to communications with suppliers and customers, services provided, development and implementation of business planning and a commitment to partnering with other companies. Taken together, these factors should be seen as inter-related variables that make up the dynamic environment in which companies operate. No one factor has priority; rather, they are dependent variables that influence each other.

Organisational effectiveness
Organisational effectiveness is an abstract concept that is difficult to measure, yet is dependent on management capabilities of reacting to both external stimuli and internal employee interactions. Instead of measuring organisational effectiveness, the organisation determines proxy measures that are used to represent effectiveness. Proxy measures used may include the number of people served, types and sizes of population segments served, and the demand within those segments for the products or services the organisation supplies.
The concept of organisational effectiveness is how effective a business is in realising the outcomes it intends to produce in achieving its overall goals. However, in order to be effective and achieve its goals a business must respond equally to environmental and organisational factors.



Management effectiveness
Managing people used to come second to getting the job done, and unfortunately in many organisations it still does. Management styles create the culture, yet they are based on the principles of relationship building. The role of today's managers is to organise and create teams of specialists to effectively achieve the company's goals and objectives.
Creating specialist teams is only part of the formula. The next step involves motivation. Identifying and tapping into the values that inspire people and unite teams is the way to drive change in otherwise outdated patterns of thinking, ultimately leading to management effectiveness.

Employee effectiveness
Employees represent the foundation of any business. Hiring, developing and retaining a quality workforce is still a cornerstone to any organisation with a focus toward employee effectiveness. Too often, business growth outpaces organisational development. Inadequate attention can yield a structural imbalance, rendering one or several persons responsible for key segments of running a business, exposing the organisation to operational and functional risks.
An ensuing situation evident in Latvia today is the exodus of human capital to other EU states in search of higher wages. This has created a labour shortage, pressuring companies to compete with one another to fill needed vacancies. Not only has this

produced a situation where both skilled and professional labour is in short supply, it also puts downward pressure on an organisation's ability to reach its full potential as it may be employing less qualified persons.

Communication effectiveness
Every organisation faces the challenge of improving communication. Corporate leaders are required to think about how they communicate, both internally within their organisation and externally with their customers, suppliers, vendors and shareholders. Internal communication means conveying information within the company and is therefore vital to its existence. External communication is a prerequisite for interaction between the company and its surroundings, directly influencing its operations. Communication plays a vital role in the management of professional organisations and their achievement of success. It has been proven that organisations demonstrating effective communication are better able to adapt to highly competitive and changing business environments. Communication, corporate culture and human resources are the key factors that determine the management of the company as well as the development of its strategies, achievements and market position.

Effectiveness - it is not how hard, but how smart you work that matters.

Although communication is associated with all areas of management, it is of greatest importance for the function of leadership. Effective communication is intentional and deliberate and its characteristic features include openness, directness, respect, responsibility and purpose. Effective communication, moreover, can be learned, improved and mastered. It is therefore necessary to take a closer look at the essence of communication effectiveness and its determining factors. Research has proven there is a relationship between effectiveness and the extent of communication between organisational units.

Service
Services and their level of quality have become an integral component of effectiveness. Companies providing either purely services or support services to strengthen existing product lines are viewing the quality component as an integral part of their success formula. Quality service is an essential ingredient for generating customer retention and loyalty. Many service-oriented businesses in Latvia are beginning to cultivate broader service offerings, conforming to consumer demand and keenly focusing on implementing and maintaining higher quality standards. Service providers are beginning to set in motion quality programmes to promote client partnering and initiate long-term relationship management strategies, where they actively participate in their customer's success.

Business planning
Critical to the success of any business is how well it develops and implements its business model. Effective business planning leads to innovative technologies and techniques that enhance comprehensive business effectiveness. Too many companies focus on business productivity rather than business effectiveness, missing opportunities to develop intelligent business decisions. Businesses in Latvia have started to embrace the notion of originating, enhancing or even outsourcing segments of their business that may otherwise detract from their core competencies both in time and cost. Logistics is a typical business segment that is operationally required so organisations opt to outsource as this is not an area where most businesses specialise.

Partnering
Businesses usually start out small, with a single core competence offering a product or service that is in demand and possibly unique. As a business grows, the requirement to establish departments, supplemental business lines and the need to cooperate with other companies develops. Eventually, businesses reach a point where they need to rationalise if partnering is an effective route. Partnering as defined in this article ranges from simple cooperation with horizontal or vertical businesses within an industry sector to the other extreme of outsourcing practices. These concepts, especially outsourcing, are still new for Latvian companies and are slow in being accepted. In order to effectively outsource a portion of a business, a level of trust needs to be developed between provider and client. This is a key element still lacking among Latvian businesses, despite the fact that outsourcing has been successfully utilised for over 25 years and is widely accepted in Western countries.

Conclusion – working smarter, not harder
Effectiveness, while dynamic and comprehensive, is in most instances merely a perception of how business is conducted and capable of adapting. The two most important things to remember about effectiveness:

- It is not how hard, but how smart you work that matters
- Effectiveness cannot be achieved overnight, rather it is an ongoing process that develops over time and is continuously refined the longer it is implemented. •

The European Company – what is it?

After decades of preparation work, on 8 October 2001 the Council of the European Union (EU) finally adopted the regulation 2157/2001 on the statute for a European company (Societas Europaea, SE) and the supplementing directive with regard to the employee involvement in a European company. The regulation enabled EU member states to adopt a totally new legal form – the European Company. The first SE established in the Baltics, SE Sampo Life Insurance, was registered in the Estonian Commercial Register on 2 January 2007.

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In its nature an SE is a limited liability company, based on share capital, whose activities are governed by the law of the member state in which it has its registered office and whose capital should be at least EUR 120,000. The management of an SE can be arranged as either a one or two-tier system; therefore, the member states, where no provision is made for such an option in relation to public limited companies, should have it established now. In Estonia, a completely new governing body incorporating both functions (i.e. management and supervisory) is provided – an administrative board.

The regulation prescribes four means of formation of an SE:

- **Merger:** at least two public limited companies governed by the law of different member states may merge to form an SE. The SE is registered in the member state in which it has its office; in the member states of other merging public limited companies the SE continues its activities through its branches
- **Formation of a holding SE:** public or private limited companies subject to the law of different member states, or which are related to other member states through a subsidiary or a branch in that state, form a parent SE
- **Formation of a subsidiary SE:** companies and other legal persons subject to the law of different member states, or which are related to other member states through a subsidiary or a branch in that state, form a subsidiary SE
- **Conversion:** a public limited company of one member state who has owned a subsidiary subject to laws of another member state for at least two years may be converted into an SE.

How SEs will exist after being established will definitely be seen in a couple of years' time. •

The European Company – a new reality

By Timo Matikkala and Sebastian Kellas (KPMG in Finland) and Hans-Jürgen Feyerabend and Jürgen Nagler (KPMG in Germany)

Since 8 October 2001 around 15 companies Europe-wide have adopted the new legal form – Societas Europaea.

Of course, at this point, many organisations will question the benefits of setting up an SE or converting an existing company into an SE. The potential benefits that have been identified so far are mainly the following:

- the possibility to carry out a cross-border merger
- the possibility to transfer the registered office of a company within 28 European countries
- a pan-European image.

Cross-border merger

The cross-border merger process is regulated in the SE Regulation, in addition to which national procedure rules are applied. For industrial companies, cross-border merger is quite often undesirable because of more complicated tax and accounting issues, although some administrative savings could be achieved. General experience still seems to show that the potential benefits derived from such a branch structure, instead of the parent-subsidiary structure, do not exceed the disadvantages. In the banking and insurance industry a branch structure is seen as a desirable operating model as more efficient bank secrecy, solvency and financial supervision practices may be achieved. Also, taxation in a branch structure can be more efficient, especially when group internal services are provided and economies of scale are sought through centralisation of operations. From a value added tax (VAT) point of view, a branch structure can provide more efficiency in dealing with exempted financing services. By way of contrast, an obstacle for banking mergers in the Nordic countries has been the unharmonised field of other sector-specific legislation, such as deposit guarantee funds that currently follow the legal entity.

Transfer the registered office

The possibility to transfer a registered office has been promoted by the SE Regulation. Such a transfer does not result in the winding-up of the SE and in the creation of a new legal person. Company law ‘forum shopping’ is encouraged; the idea is that this would lead to the practical integration of company legislation in a similar way that has happened in the US, where company law in the state of Delaware is the leading standard. It remains to be seen if this mechanism will work in Europe, since taxation especially could be a hindrance for this kind of development.

The Mergers Directive (90/434/EEC), with its later amendments, still requires that a permanent establishment is left behind whenever a legal entity moves away from one jurisdiction. A basic principle therefore is that no income-generating assets or business can leave a jurisdiction without an exit tax. As long as assets and business remain effectively connected with a permanent establishment to be formed in the country from which a legal entity is disappearing, the transaction is tax neutral.

Exit taxes have recently been under the microscope in the European Court of Justice (ECJ). Irrespective of these problems, the mere possibility to transfer an SE's registered office seems to be an option that companies are ready to embrace.

Regarding transfer of a registered office, the Finnish legislature has taken the position that Finland will respect completely the value of the tax base that was in place before the transfer of the registered office in the old home state. Other member states may possibly apply similar rules, but not necessarily. This approach would seem to be in harmony with the objectives of the Mergers Directive and is unlikely to be considered discriminatory by the ECJ.

An SE merger also makes it possible to register the company in a completely new member state of the European Economic Area, a possibility not available through the directive on cross-border mergers.

Pan-European image

Last but not least, the mere image of a company having a European status, instead of a national status, can be important. For example, for Elcoteq SE in Finland this has been one of the main drivers for adopting the new legal form. Drivers behind the image can be manifold, such as better credibility among clients, coming closer to competitors and peers, and a certain European passport when setting up business (in the form of a branch office or similar) in new areas where the legal form of foreign national companies is not well-known.

Level of harmonisation of legislation

One of the main problems regarding SEs remains the disintegrated legal framework. At present, there is no uniform approach to company taxation in the EU. The cross-border formation of an SE has been harmonised by amending the Mergers Directive. These rules were to apply to SEs from 1 January 2007, at the latest.

In Finland, a tax neutral conversion in every possible respect has been confirmed in a tax ruling of the Central Tax Board 35/2004.

Another question is how the new structure will be taxed, once formed. Since the cross-border transactions always lead to a branch structure, branch tax issues are clearly relevant. The EU has so far done nothing to harmonise the taxation of this kind of structure; rather, this is left to principles of international taxation. Ironically, the situation is exactly the same with company law, where the SE Regulation mainly deals with formation of an SE, but the life of an SE after that relies on national company law applicable to local public limited companies.

One practical barrier is established by the division of European integration into EU and EEA (European Economic Area), the latter including the EU countries, Norway, Iceland and Liechtenstein. Although the company legislation on SEs has been stretched to cover also the three EEA member states, the tax harmonisation has not. The Mergers Directive only applies in the 25 EU member states. This means that it is possible to include the three EEA countries in SE related transactions, but a tax neutral implementation is not guaranteed on a European level.

Future development

The future of European companies in Europe seems to be good and the number of companies adopting the legal form is increasing constantly. Certain doubts over the need for the new company form have been raised since the directive on cross-border mergers of companies with share capital (2005/56/EC) was adopted, being nationally implemented by 15 December 2007. Although the new directive broadens the possibility to carry out cross-border mergers, the need for the SE company form does not decrease significantly. First of all, the European image of an SE cannot be achieved by applying the new directive. An SE merger also makes it possible to register the company in a completely new member state of the EEA, a possibility not available through the directive on cross-border mergers. Furthermore, the transfer of registered office is only possible for SEs, though a directive for providing the same possibility to other companies with share capital is in process. The legal company form of an SE has given a new flexibility to the European markets. However, like so many other instruments, some companies can benefit from it and some cannot. •

The above is an excerpt of an article published in International Tax Review, Industry Guide: Financial Services, 2006

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AUDIT ▪ TAX ▪ ADVISORY

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The first Societas Europaea in the Baltics – the result of a working relationship of legal advisers

Hannes Vallikivi and Kristi Kullerkup from the law office of Tark & Co offer insights from their practical experience

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Your office has the honour of being the legal adviser for the first registered SE in Estonia as well as within the Baltics. What are the main advantages of the new SE company form?
First, an SE can be established through cross-border mergers of companies. At the moment, no other business combination form allows such mergers. A cross-border merger enables companies to consolidate capital, optimise labour costs and simplify management schemes. Second, an SE is a unique legal form, as it allows transferring a company from one country to another without the obligation to dissolve the company in the original country and create a new one in the new home country.

What were the major problems you came across during the registration process?
As an SE merger is constrained by a definite time frame and carried out in several countries simultaneously, different legal systems in member states can be regarded as being the largest problem. Even though the national law of a country is based on EU law and in general terms, rules are similar, details can be different (e.g. general regulations for commercial law), and in some cases the national law lacks precise rules and procedure periods. Regardless, any new procedures need an introduction period to work smoothly.

From a practical point of view, could our legislature, within its competence, have regulated certain aspects differently?
The Estonian legislature does not have much room for manoeuvring within the SE regulations. The procedures for creating and managing an SE have been established by the directly applicable EU regulation. However, the regulation delegates several issues to the local law of the member states. Some procedure periods, etc., provided by the Estonian legislation would clarify the process, but the Estonian regulation as a whole is sufficient for creating and operating SEs here.

How long was the procedure from initial preparations to the registering of the SE?
Legal preparations started in October 2005 and the process completed

in January 2007, i.e. 16 months all together. However, those 16 months included several waiting periods – e.g. warehouse procedures performed by financial supervisory bodies, periods for submitting creditors' claims in Latvia and Lithuania, etc. Therefore, those 16 months did not contain continuous active work. In the case of a less complicated merger the period would be significantly shorter.

the authorities and our initiative was received kindly.

Can you predict whether new SEs will be registered soon in Estonia and in the Baltics?
Another life insurance company has signalled their intentions to perform a cross-border merger. In Latvia, an SE has been created as a result of conversion.

An SE is a unique legal form, as it allows transferring a company from one country to another without the obligation to dissolve the company in the original country and create a new one in the new home country.

How would you assess the other Baltic States' readiness for applying the SE regulation?
Surprisingly, everything went smoothly. Latvian and Lithuanian members of our working team (attorneys from the Latvian law office of Loze, Grunte & Cers and the Lithuanian law office of Sutkiene, Pilkauskas & Partners) had very good working relations with local commercial registers and financial supervisory bodies. As this was the first time for such an endeavour, we often had to suggest solutions to

Meanwhile, we have received several inquiries about the nature of SEs and formation procedures.

What could be alternatives to an SE for companies wishing to harmonise their structure within the Baltics?
I am unable to see any alternatives at the moment. When we speak about concentrating assets into one country and creating a branch structure, a cross-border disposal of assets (a company) is far less favourable than a cross-border merger. However, by the end of this year the situation should change. By 15 December, all member states have to implement the directive on cross-border mergers of limited liability companies. Then, public and private limited companies can also merger without the obligation to establish an SE. An SE merger will remain for those companies who would like to transfer their location within the member states of the EU. In other situations, a less complicated alternative will apply. Although the merger procedures are more or less similar to those of an SE, there is no strict requirement that the merging companies should be public limited companies (or, ASs in Latvia and ABs in Lithuania). Also, the procedure for employee involvement is simpler.

Which accounting rules apply to the branches of an SE? Is the accounting of the local branches governed by general guidelines or have special guidelines been introduced for an SE's branches?
Within Estonia, general accounting guidelines applicable for ordinary branches should be applied to the branches of SEs. According to our information, the situation is the same in Latvia and Lithuania. •

Can a European company help solve tax efficiency issues?

There has been a lot of talk about the usefulness and benefits of establishing a European company (SE). But the doubts regarding SEs are almost as numerous. Both pros and cons are also present in the field of taxation. Taxation issues are one possibility to save costs. This article will discuss how to economise on costs from the tax perspective and deal with the situations that do not benefit through the establishing an SE.

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Within Europe, rules for facilitating the creation of SEs have been introduced (first of all, concerning the taxation of SE mergers). However, the continuing operations of an SE will primarily be controlled by the local law of any particular member state. Harmonising broader legal frameworks with a consensus amongst the member states can probably not be achieved in the near future. Therefore, local law governs the cost-saving process related to establishing an SE and reforming a company into a branch.

In the context of Estonia, several of those issues do not have as serious an impact as in traditional tax systems. In Estonia, taxation will take place when an Estonian company is distributing its profit. In this case, it is essential to avoid double taxation. However, it may happen that our Income Tax Act does not provide you with effective approaches. As a rule, the profits earned by a permanent establishment that have been taxed in another country, can be repaid as dividends in Estonia without an obligation to additional taxation. In countries with the traditional tax system, as in Latvia and Lithuania, a company may be deprived of its losses and reserves during the reformation.

In certain cases, establishing an SE and reforming member states' companies into branches (permanent establishments) can provide some tax efficiency - the benefit is available for persons delivering exempted services (financing institutions, insurers, etc.). Namely, in many countries, including Estonia, the law does not consider transactions between a head office and its branches as a supply. For example, when receiving services from its head office, an SE that is a

permanent establishment in Estonia whose supply is constituted as an exempted supply, is not subject to VAT expenses as a result of the reverse charge.

The rule stating that services delivered between a head office and its permanent establishment is not considered a supply, is not applied in all member states. In Lithuania, for example, special requirements are established for acquiring that privilege. In Latvia, such transactions are regarded as a supply and therefore the reverse charge is imposed on services received from the head office.

Establishing an SE and reforming companies into branches does not solve transfer pricing issues, as transfer pricing rules also encompass transactions between a head office and its permanent establishment. Therefore, parties have to apply arm's length prices to their SE transactions as well. For example, if the head office of an SE registered in Estonia delivers services to its branch in Lithuania, the value of the transaction has to be evaluated objectively. If the persons are subject to a documentation obligation, the required master file and country-specific file have to be prepared regardless of the fact that the other party is a permanent establishment. It should be mentioned, that some unfavourable consequences may be experienced due to tax regulation of branches that is less explicit than that of companies. For example, in Latvia and Lithuania several restrictions have been imposed on branches. Quite often, when implementing the rights arising from tax treaties, one has to communicate with the tax authorities of the corresponding countries.

Registering an SE does not help save costs on accounting or reporting taxes either. For instance, when reforming a company into a branch, the branch has to be re-entered into registers (e.g. as a person liable to VAT). The SE has to continue submitting tax declarations in each country the way branches usually do.

In conclusion, it may be said that costs can mainly be saved on VAT in the case of financing institutions and insurers, providing the law of the particular EU member state allows it. Companies operating in other areas find it quite complicated to save tax costs when registering an SE. As in other situations, effective approaches can be achieved by combining the impacts of tax laws effective in various countries. •

Establishing an SE and reforming companies into branches does not solve transfer pricing issues, as transfer pricing rules also encompass transactions between a head office and its permanent establishment.

The human resources management efficiency audit – an opportunity to take centre stage

All business processes change in conjunction with a company's growth, increased staff numbers and structural changes. The issue of the efficiency of the existing human resources management processes and how they facilitate the achievement of the company's strategic goals becomes pertinent.

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Are there enough staff employed at the levels directly involved in realising the company's strategic goals? Does the remuneration system align with the employees' abilities? Are the available training resources suitable for the respective company and its development plans? What is the level of employees' motivation and satisfaction in your company and are they motivated to work productively and proactively? Human resources management efficiency audits study and evaluate the adequacy, legality, efficiency of usage, development opportunities, cost effectiveness and compatibility with the company's sphere of operations, direction and dynamics of the respective company's human resources. A human resources efficiency audit may encompass all or part of the human resources management sphere including staff record keeping, workforce planning, selection, motivation, the remuneration system, training, evaluation and development.

In the first instance, efficiency ensures **compliance with laws and regulations** – if mistakes are made in this stage of the chain, the entire organisation of the human resources management process can collapse like a house of cards. However strict and occasionally bureaucratic they may be, labour laws afford companies the opportunity of developing different approaches to organising staff record keeping while ensuring that laws and regulations are followed. After assessing the company's size, area of activity, personnel indicators and development plans, an experienced auditor will be able to recommend the most suitable approach for organising staff record keeping and processes, speeding up the human resources management process and improving its quality, and ensuring access to staff information, ease of use, data security and long-term storage. A staff record keeping audit may also be entrusted to a solicitor with experience and knowledge of labour law, but only a specialist with experience of human resources management in companies of various sizes and in different sectors and who has information about the world's best practice in the respective human resources management sphere will be able to determine the efficiency of organising staff record keeping. Human resource management process efficiency auditors often make reference to so-called **"international best practice"**, evaluating and if necessary offering their clients alternatives to existing human resources management processes in the organisation.

However, an old saying applies to human resources management: "What fits all isn't fit for anything". A successful human resources management process model for one company cannot serve as a universal example for every organisation, because a solution that raises efficiency in one company may cause disruption and loss of productivity in another. At this stage, the competency and diversity of experience of the person conducting the audit is especially important for them to be able to compare various companies and models for organising human resource management processes and to determine the keys to success for companies that have benefited from the process.

The most significant benefits obtained from carrying out a human resources management efficiency audit are:

- An objective assessment of the legality of the human resources management process and its compatibility with the company's strategic goals and development plans as well as the efficiency of the usage of the resources available to the company
- Recommendations for optimising the company's human resources management process taking into account internationally recognised best practice
- Evaluation of the productivity, fairness and ethicality of the applied human resources management methods
- The possibility to efficiently direct the resources available to the company to facilitate the realisation of strategic goals.

Since human resources management efficiency audits are usually conducted considerably less often than financial audits, notwithstanding the required financial investment it is recommended that this process be entrusted to professionals with experience in realising similar projects – in other words, internationally recognised auditing companies or advisers with experience in personnel management. The end result will be both a qualitative audit report and an objective external evaluation. However, the key factor in conducting a human resources management efficiency audit is the positive interest of the company's own management and a desire to maximise the contribution of human resources management in the company's overall development. The desire to develop is what differentiates companies with prospects for growth from ones that have already reached their peak. Effective human resources management is a powerful competitive tool for a company, because not infrequently skilfully selected and implemented human resources management strategies are visible only to the employees of the respective company, thereby denying competitors the opportunity of copying successful approaches and innovations. This simultaneously leads to improvements in the company's internal organisation, competitive advantages in relation to other market players and and consequently each employee is motivated to assist the organisation in reaching its financial goals. •

Effective human resources management is a powerful competitive tool for a company, because not infrequently skilfully selected and implemented human resources management strategies are visible only to the employees of the respective company, thereby denying competitors the opportunity of copying successful approaches and innovations.

Jack Welch – a pioneer of talent management

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"My main job was developing talent. I was a gardener providing water and nourishment to our top 750 people. Of course, I had to pull out some weeds, too."

One of the world's most celebrated and acknowledged management gurus, Jack Welch received his B.S. in chemical engineering at the University of Massachusetts in 1957, and his M.S. and Ph.D. at the University of Illinois. He joined the major American corporation General Electric (GE) in 1960 as a junior engineer. In 12 years he became a vice-president of GE, and from 1981 he ran the corporation as the Chairman and CEO.

During his tenure (1981-2001), the market capitalisation of GE grew by USD 400 billion, making it the world's most valuable corporation. The company has enjoyed consecutive annual growth around the globe, in multiple markets and against brutal competition. Fortune Magazine has named Welch the "Manager of the Century".

Quite often, the reign of top executives is too brief, and their successors inherit the credit for the impact of their strategic decisions and management standards introduced by them. Therefore, it is rather difficult to estimate who or what is responsible for their success or failure. Welsh's 20 years of leadership arguably link the corporation's long-term success to his personality and the choices he made there.

Jack Welch's ideas and initiatives in GE, such as the Sixth Sigma quality programme, growth of a company's turnover and profits through globalisation and application of Internet-based business solutions, have helped create the fundamental concepts of contemporary corporations.

However, the most enlightening of Jack Welch's ideas – and worth following – is probably his concept of "manager as a leader" who sticks to the basic definition of management: management means achieving results through other people. Welch's management philosophy in GE was based on his unfaltering faith in the critical role of talented leaders in achieving a company's results and success.

Based on an extensive survey carried out by McKinsey & Company, the authors of "War for Talent" Beth Axelrod, Helen Handfield-Jones and Ed Michaels stated that along with the 21st century, a war for talent broke out and from this time forward, the fight for talented executives is a key issue for all companies worldwide.

Jack Welch was possibly one of the first corporation leaders in the world who adopted the talent-focused attitude and undoubtedly, it was one of the main factors in GE's long-term success.

Welch has provided us with a series of quotes emphasising the importance of talent development in an organisation:

- Getting great talent, giving them all the support in the world and letting them run is the whole management philosophy of GE.
- If you pick the right people and give them the opportunity to spread their wings and put compensation as a carrier behind it you almost don't have to manage them.
- Giving people self-confidence is by far the most important thing that I can do. Because then they will act.

Along with talent management ideas, concepts of a learning organisation and encouraging employees' initiative were two other building blocks of the GE management philosophy.
Some of the most widely known quotes by Welch about a learning organisation:

- An organisation's ability to learn, and translate that learning into action rapidly, is the ultimate competitive advantage.
- I've learned that mistakes can often be as good a teacher as success.
- Willingness to change is a strength, even if it means plunging part of the company into total confusion for a while.

Providing talent management principles are quite universal, we have a lot to learn from Jack Welch. Of course, every company has to analyse its talent management system and to adjust it to their needs and possibilities depending on the company's size, culture or level of globalisation.
It is clear that talented employees give a company an enormous competitive advantage. I suggest you commence by answering these three essential questions if you have not already done so:

- What does "talent-focused approach" mean in my company?
- How could that approach be conveyed to other top company executives?
- How could we create an environment which would attract the most talented people to our company?

Jack Welch: "Management means achieving results through other people."

Effective merger: 10 things to remember

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The term "merger" describes the highest form of strategic partnership, in which two or more legally independent organisations merge together into one organisation – both legally and financially.

Merger mania continues. As an illustration, the Lithuanian market has been awaiting the concentration of the retail industry. Rumours of the IKI retail chain going on sale have been circulating for a year already. Rimi has split with its former partner Kesko. VP Market is concentrating its main assets and has been renamed to Maxima.

Other industries are active as well: Bite UAB – second largest mobile telecom provider – was just recently sold by Danish operator TDC. US real estate investment management firm Heitman has purchased a logistics centre next to Vilnius, and many more.

This is not the first time we are delving into the problems surrounding Mergers & Acquisitions (M&A) in the pages of KPMG Forum. Janek Taaler, Financial Adviser from KPMG's Estonian firm ("Financial Advice Pays Off", Winter 2007) covered many important topics, but they all concentrated on the Pre-Merger phase: Financial and Legal Advice, Financial and Tax Due Diligence, etc.

This article, however, is the start of a series about post-merger issues and will outline their 10 main focus areas and provide you with a review of why almost 58% of mergers fail. The post-merger integration process is a difficult and complex task. It comes along with long lists of activities and tasks that have to be fulfilled within a short time-frame and partially with incomplete information (e.g. the formation of new teams and departments). There are a number of opportunities to exploit and many decisions to make.

There are many different approaches to analysis of a merger and the establishment of the risk factors. All of them are correct and I encourage you to use at least two or three methods at the same time. Many of the critical success factors of the integration phase are so-called "soft factors".

Therefore, it is necessary to focus attention on issues like:

1. Communication of the new strategic objectives and the new vision of the merged organisation
2. Implementation of a new shared corporate culture and management culture

3. Development of a new management structure for the new, larger organisation, especially overcoming of leadership problems in very large units
4. Bringing together formerly separate units from both former organisations
5. Harmonisation of management compensation and management incentive systems
6. Overcoming of language barriers and country specific cultural differences
7. Overcoming of staff's suspiciousness of the other organisation ("Us vs. Them" syndrome)
8. Filling of management positions and allocation of responsibilities
9. Knowledge transfer among units that are to be integrated
10. Maintenance of customer relationships during the integration phase.

A merger without a clear and realistic vision may lead to similar negative results in terms of shareholder value as mergers based solely on fit-approaches may do.

Many mergers fail because of negligence to cover one or more of these issues.
By analysing the soft factors we can develop the "vision" for a merger. An ATKearney study* showed that most companies already struggle with this initial step. Development of the vision plays a critical role in post merger integration. The following findings support this:

- Most companies see compatibility (i.e. fit in terms of customer base, regional coverage, product portfolio, etc.) as more important than a shared vision in mergers.

In the ATKearney analysis, 78% of participants thought a "parallel" past was more important than a common idea of the future. However, in private life, would you start a relationship with somebody whom you do not share a common idea about your future as a couple? Probably not.

- Most mergers fail. 58% of mergers analysed by ATKearney did not complete successfully since the deal did not meet the sides' expectations nor their objectives. The reasons vary.

ATKearney contends that some mergers fail to meet expectations because they were much too high. Others meet some of the initial objectives but do not achieve the same performance in terms of growth and shareholder returns as their competitors do.
In fact, many mergers destroy value instead of creating value.
Factors like corporate culture and existing value systems, staff qualification, core competencies and intellectual capital, leadership styles and communication systems, and the strengths and weaknesses of the critical success factors of each business unit should be included in the pre-merger analysis. These factors make or break the merger of the up-to-now separate corporate systems. A "good fit" approach looks at the past and – at its best – at the present. It is not able to give the new organisation a promising strategic direction nor drive integration. An important success factor that is not related to a fit in products or markets is, for instance, the degree to which the merged organisation can develop a new culture that is accepted by the members of both "old" companies.
In order to initiate the necessary activities and to grow together in these soft issues, the company needs a guiding "road map" that gives direction – the vision.
The development of a corporate vision is not as easy as one might think. A merger without a clear and realistic vision may lead to similar negative results in terms of shareholder value as mergers based solely on fit-approaches may do. Visions are born from good ideas, often developed by visionary people in endless meetings and projects. The problem is that many ideas look promising at the first sight, but prove to be useless later on. But this is only one out of three "whales" your successful merger is being built on. We just covered the first: "Vision level and 10 important things to consider". This stage covers "People & Culture" - it doesn't matter if we are talking about management of the new organization or the work force. As cancer starts with just one cell, an organisation can be destroyed by only one human and this person doesn't have to be as strong as Hercules. There are two other levels: the Operational level with all business processes and activities, and the Technology level covering IT and communications. Yes, IT is separate – don't be surprised. In the next issue of KPMG Forum I will explain why. •

**Source: Vision as Key Factor in Merger Processes by Oliver Recklies published at themanager.org*

Alternative securities markets – introduction of "First North" in Baltic countries

Indars Aščuks
OMX Riga Stock Exchange
Deputy Chairman of the Board

Indars Aščuks has been the Deputy Chairman of the Riga Stock Exchange Board for more than two years. He is also a Board Member of Latvian Central Depository. Mr Aščuks has worked at the Riga Stock Exchange for 6 years and during this time has been responsible for several strategically significant projects in Latvia and the Baltics.

Two reasons stand behind the rapid development of the alternative securities marketplaces in Europe.

Firstly, in light of recent European Union regulatory changes in financial markets and the increased competition in attracting high-growth and high-potential issuers, stock exchanges all over Europe have started to introduce less regulated securities market segments or so-called alternative markets. Secondly, alternative markets meet the needs of small- and medium-sized enterprises (SMEs) striving for growth. Traditionally, SMEs have been heavily dependant upon bank financing, therefore the opportunity to access equity financing can propel faster and more efficient development of those companies.

Alternative markets in Europe – recent developments

The pioneer among stock exchanges was the London Stock Exchange, which introduced its Alternative Investment Market (AIM) as early as in 1995. Today AIM is a benchmark for alternative markets across the World. AIM's success story has encouraged other stock exchanges to follow. As a result OMX – the operator of seven Nordic and Baltic exchanges – introduced its First North alternative market concept, which is now Europe's second largest alternative marketplace. First North has already been introduced in Copenhagen, Stockholm and Reykjavik, and in 2007 it will be set up in Helsinki and at Baltic stock exchanges in Riga, Tallinn and Vilnius. Other leading European stock exchanges have also recently launched their alternative market concepts – in 2005 Euronext has introduced its Alternext offering, while Deutsche Borse has came up with its Entry Standard market segment.

The differences between alternative market and regulated market

In essence alternative markets are securities trading platforms that have been tailor-made for the trading of SME shares. The basic principles of operation of alternative markets are very similar to those of regulated stock exchanges, but there are some notable differences. The table below sums those up:

The target audience

With the introduction of alternative markets stock exchanges have tried to bring the efficient distribution of financial resources that characterises the stock markets to the SME segment. Previously this function of a regulated stock market could not be applied to SMEs as the size of those companies lacked the critical mass necessary for listings on stock exchanges (around EUR 30-40 million in Baltic exchanges). As a result, before introduction of alternative markets all the benefits of stock exchanges were available only to a very limited number of companies. Alternative markets are targeting SMEs and therefore are capable of bringing stock market benefits to SME segment companies.

In essence alternative markets are securities trading platforms that have been tailor-made for the trading of SME shares.

Baltic main market	First North Baltic
Status of the market and supervision	
FSA monitored market, subject to Financial Instruments Law and EU directives	Market operator regulated marketplace, subject to market rules set by market operator
Entry conditions and circumstances	
At least 3 years in operation	No minimum years of operation
Minimum free float at least 25% or shares amounting to EUR 25 million in public hands	No minimum market value and no free float requirements
Prospectus is approved by FSA	Prospectus necessary only for initial offering
Listing fee	Reduced listing fee
A number of external advisors (investment bank, law office, international auditors) usually necessary	Requirement to enter into service agreement with a company from Certified Advisors list
Information disclosure	
Financial accounting according to IFRS	Financial accounting according to local accounting principles
Quarterly financial reports	Semi-annual financial reports
Information disclosure in local language and in English	Information disclosure in one language (local or English)
Follow corporate governance code	No requirement to follow corporate governance code
Risk perception by investors	
Controlled risks on main market, because of high admission and information disclosure requirements on companies	Higher risks on alternative market because of lower requirements on companies

Benefits of alternative markets

In general alternative market issuers receive the same benefits as do regulated market issuers but for relatively lower price. The main reason that attracts issuers to the alternative market is additional capital. Firstly, it helps develop faster as in some stages of a company life cycle organic development can provide very limited growth potential. Secondly, equity capital in many cases can be the only alternative for the financing of riskier and more ambitious projects and development plans as banks, when providing their loans, normally have a considerably lower level of risk tolerance in comparison to equity investors. Alternative markets eliminate this inefficiency providing necessary equity capital to a company segment that has previously been neglected by public stock markets.

The role of advisers on the alternative market

Certified advisers approved by an exchange are crucial to the successful operations of the alternative market. Experienced and professional advisers active in corporate finance or other advisory spheres are attached to every alternative market issuer on a continuous basis. Advisers assess the suitability of companies for admission to the market and inform potential issuers about their obligations in relation to the listing of shares on the alternative market. In addition to that advisers help companies with the development of admission related documentation.

First North - alternative markets in Baltic countries

OMX Baltic stock exchanges in Riga, Tallinn and Vilnius are planning to implement the First North concept in the near future. The existing First

North offering will be somewhat adjusted to fit the needs of local businesses and companies. The alternative market will have the same requirements in all three countries. First North is the second largest alternative market in Europe with market capitalisation of EUR 4.4 billion and more than 86 issuers admitted to trading. 16 companies raised equity financing on First North in 2006, amounting to EUR 220 million.

Investment in alternative markets

Taking into account the previously mentioned differences between alternative markets and regulated stock exchanges investments in alternative markets is riskier in comparison to those on regulated markets. Because of lower listing and information disclosure requirements, regulated market issuers are less transparent. However, since investments in alternative market issuers are normally done in the early stages of development of those companies there is a chance that one can obtain a share in future blue chip and industry flagship for a very low price.

Case studies

Goal - to expand its international turnover

The Danish laptop producer Zepto went to First North in order to expand its international turnover. In November 2006, Zepto issued 312,500 new shares, sold an existing 624,500 shares and raised EUR 4 million. Total shares placed amounted to 22% of the company's total shares after IPO.

10 million euro in 17 minutes

17 minutes after becoming listed on the stock exchange First North, Notabene.net's shares were completely sold out. Thus the company earned DKK 10 million (EUR 1.35 million). Managing director of Notabene.net Brian Metz says that the company chose First North after having considered the Copenhagen Stock Exchange as well as other exchanges in Sweden and England. First North was chosen due to the fact that it was easy to become listed, says Brian Metz. ●

KPMG in Estonia has moved to a New Location

KPMG in Estonia has moved to a new and larger office in Tallinn. This is to meet its present and future needs for space, and to provide its staff with the best surroundings, equipment and facilities to serve our clients. Since end of March we are located on the 6th floor of Forum Business Centre. The Centre is located in the heart of Tallinn's business and shopping district, a block away from our former office.

Our new address is:

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We are looking forward to meeting you in our new office!

Marek Uusküla, Deputy Head of the Department of Tax Policy of the Ministry of Finance, and his partner in a dancing mood

KPMG key persons' surprise performance to thank the guests

A spectacular experience - an original pop-rock cello trio Melo M from Latvia

Something important to discuss - Rait Toompere, Member of the Management Board of SA Archimedes and Urmas Roosimaa, a leading auditor of KPMG

Discussion in full swing (from left) Jüri Sakkeus, KPMG strategy advisor; Jaan Allem, Chairman of the Board of Glamox HE AS; Endel Palla, Chairman of the Supervisory Board of Harju Elekter AS and Madis Talgre, Chairman of the Board of AS Harju KEK

KPMG
15
in Estonia

◄ The mastery of dance art was demonstrated by the Estonian Dance Agency

Stephen Young, Chairman of the Management Board of KPMG in the Baltics, delivering his welcoming speech illustrated by an enlightening story of a shepherd and his sheep ►

Dust off your dance shoes!

At the beginning of March, KPMG in Estonia celebrated its 15th anniversary amongst major clients, business partners and a number of selected ex-employees. The celebration took place in Estonia Concert Hall and the programme was dedicated to the art of dance. The lively evening was filled with excellent entertainment: exiting melodies, spirited dancing, delicious food, the best company…

Instead of gifts, we asked our guests to make donations in support of visually impaired children and youth.
We are very pleased to announce that a significant amount of 73,465 Estonian kroons was donated. The money will be used for acquiring appliances with speech support (a laptop, accessories, a programme) for members of the South-Estonian Association of the Blind. Thank you for your contributions!

▲ Flowers are handed by Lauri Liipa, Managing Director of Fazer Eesti AS

◄ Dave Benton's songs soon filled the floor with dancers

KPMG partners (from left) Taivo Epner, Andres Root and Andris Jegers greeting Indrek Teder, an attorney at law ▼

▲ Erki Uustalu, Chairman of the Supervisory Board of AS Eesti Loto, and his partner seem to enjoy the party

◄ Andris Jegers, CEO of KPMG in Estonia, is inviting everyone to the cake

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