

Comment

Transplant SFO's body – don't chop off its head

As a separate "white collar" law enforcement department, the Serious Fraud Office contends it is helping to enhance investor confidence and encouraging investors to invest in the New Zealand economy.

We need honest capital markets, and it's keeping the markets honest by prosecuting crooks and deterring potential offenders.

As explained in its annual report to Parliament last year, the services the SFO provides "contribute to the government's strategic objectives, mainly in the areas of encouraging a strongly growing, internationally competitive enterprise economy and building an economically strong and cohesive New Zealand."

The agency in 2000/01 had 36 staff and a budget of \$4.4 million to do this work as the nation's scam-busters.

The busting is normally done without much noise. Under the directorship of David Bradshaw, the SFO has been a low-profile outfit. A newspaper article three years ago quoted him as saying: "We are not a headlines organisation."

He preferred, he said, neither to confirm nor deny whether the agency is looking into something, because this has great potential for unfairly damaging people's reputations. "The fact that the SFO is investigating is of immediate interest," he observed.

This aspect of the office's operations exposes it to the danger of becoming an instrument of political mischief-making, or of having its reputation tarnished because people suspect it has become an instrument of political mischief-making.

This was demonstrated last week, when the media revealed the SFO was investigating the alleged misuse of Fay Richwhite donations to the National Party in 1996.

The spotlight moved quickly from a police investigation into the relative trivia of Prime Minister Helen Clark's doodle-signing to aspects of the Fay Richwhite donation and party funding issues.

National president Michelle Boag suspected Labour had instigated the inquiry to embarrass her party.

It was not the first time the SFO has dragged politicians into its investigative net. In 1993 it gave a clean bill of health to John Carter, then junior government whip, whom Labour opponents had accused of involvement in financial wrongdoing and corruption in Northland.

More recently, ACT's Donna Awatere-Huata was cleared of claims she had improperly used her expenses.

The Independent BUSINESS WEEKLY Editorial

Most ignominiously, the office became embroiled in the winebox controversy. Chas Sturt, the office's director at the time, admitted during a commission of inquiry that he did not make a full investigation of the winebox documents and that a 1994 statement to Attorney-General Paul East, in which he had said the office had investigated the documents and found no evidence of fraud, was not "strictly" correct.

There was further cause for the public to wonder about the office after it decided to re-examine the winebox files in August 1999.

Almost a year later, it declared it had decided not to prosecute anyone linked to the transaction at the centre of allegations of tax fraud.

Bradshaw, Sturt's successor, said a prosecution "would likely fail in its attempt to establish the required criminal intent."

The Serious Fraud Office was established in 1990, charged with detecting and investigating cases of serious or complex fraud and to prosecute offenders.

It is a moot point whether the SFO had to be established as a separate agency. The job might have been done just as effectively by a specialist unit within the police.

There can be no doubting the SFO's claims that special skills are needed to combat serious or complex fraud. It is true, too, that several countries have established agencies like the SFO as a means of developing those special skills.

The work is complex and demanding, requiring the SFO to operate somewhere between the criminal law and the commercial law.

The office must establish whether a fraud has been committed, then prove the fraud in a court of law.

It is not unusual to receive 10,000 or more documents in any one investigation, the office claims.

The work is time-consuming. Most SFO prosecutions take between 12 and 24 months to go through all the preliminary stages and reach a trial date.

Generally, the SFO takes control of cases where fraud involves more than \$500,000, where the fraud has been perpetrated "by complex means," or where the frauds are "likely to be of major public interest and concerns."

Why couldn't this be done by a specialist team within the police?

In 2001/01, according to the annual report, the SFO had 46 cases on its books at the beginning of the year either for assessment/detection, full investigation or prosecution. During the year 94 new cases were received and two reinstated, giving the office an overall caseload of 142 files. By the end of the year this had been reduced to 52.

But only 12 investigations were completed and proceeded to prosecution. Nine were referred "to other more appropriate agencies," including four to the police.

The police must become involved anyway, if the SFO wants a suspect locked up, because the SFO does not have the power of arrest.

The most dubious aspect of the investigation into the Fay Richwhite donation to the Nats is that director David Bradshaw told Attorney-General Margaret Wilson what it was doing before it told National leader Bill English.

More perturbing, he had advised Mark Prebble, head of the Prime Minister's Department, before putting the Nats in the picture.

The SFO legislation underlines the office's independence. It says the director shall not be responsible to the Attorney-General, but shall act independently, in matters relating to decisions to investigate suspect cases of fraud or to take prosecutions.

Bradshaw denied his independence had been comprised. He had made his decisions without consulting anyone, he said. "Who I advised after that is an entirely separate matter, and that does not compromise my independence at all."

Maybe not. But his alerting Prebble did bring Bradshaw's judgment into question and inevitably led to National Party demands for his head.

But on the face of it, it doesn't seem appropriate to sack Bradshaw. The Nats should more usefully call for a hard look into the SFO and the extent to which it serves its stated strategic economic purpose.

In short, why demand a head be chopped off when the smarter way to go might be to transplant the whole body? In this case, into the police force where it would seem to belong.

– Bob Edlin

Employee share ownership adds to the bottom line

Stewart Forsyth

Mark Todd's series on the potential value of employee share ownership (*The Independent* 17 & 24 April, 1 May) underlines employee share ownership as a means to attract and motivate outstanding performers to the knowledge-intensive companies New Zealand wants to encourage.

Evidence shows that employee share ownership also contributes to the performance of businesses.

In 1996-97 American researcher Jim Guthrie looked at the relationship between 11 "high involvement work practices" (HIWP) and the performance of 164 larger New Zealand businesses.

Guthrie developed the HIWP index from international research about what human resources practices contribute to the business bottom line. These high involvement work practices include:

- organisation-wide incentives – eg, gain-sharing or profit-sharing;
- employee shareholding.

Organisations using more of the high involvement work practices, including the incentives, had higher productivity (sales/employee).

These were significant effects: there was an average \$167,600 difference in the sales per employee of organisations which were one standard deviation above the high involvement work practices mean compared with those one standard deviation below it.

The sum was the difference between \$396,200 and \$228,600 in sales per employee.

Guthrie's results are not one-off but in line with international research.

Watson Wyatt is the consulting firm that has done the most work in this area. Out of a total of 25 value-adding HR practices, the following added value to US corporates (measuring market value and total return to shareholders):

- employee shareholding;
- paying top performers significantly more than average performers;
- paying above the market;
- linking pay to the company's business strategy;
- using employee performance appraisals to set pay; and
- employee participation in a profit-



Companies made significantly more revenue per employee if they followed "high involvement" practices

sharing plan based on the firm's overall success.

The five-year total return to shareholders varied from 53% for those low on the total HR index, to 88% for medium users of the HR value-adding practices, and 103% for high users.

Employee participation in profit-sharing based on the business unit's success was among five value-destroying HR practices.

There is no research yet into why the business unit-based incentives

fail.

My view is that they contribute to risk of a mismatch between individual contributions and rewards. People have well developed "unfairness detectors" which, when activated, tend to demotivate.

Businesses wanting to develop a high performance culture should design their performance-management so that people can see the relationship between their effort, performance outcomes and, in turn

the performance consequences – including financial incentives such as shareholding for the value-creating employees.

It is very easy – the Enron example comes to mind – to screw up the people and performance management systems and destroy value.

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