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Faculty of Finance and Management

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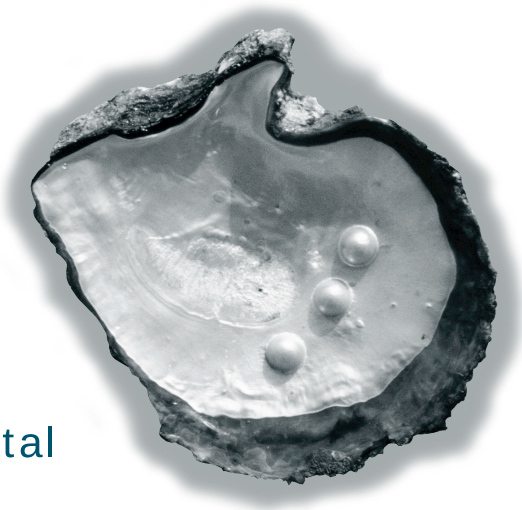
A question of value



Göran Roos and Joe Peppard on intellectual capital
page 3

David Phillips on the benefits of ValueReporting
page 7

THE NEW AGE

Exploring shareholder value creation

page 12

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Faculty faces

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How to get value from IC on the web

These web sites may be useful for readers interested in intellectual capital issues:

Creating Value from your Intangible Assets – report from the DTI in association with a number of partners, which includes the ICAEW's Centre for Business Performance.
The report looks at the successes organisations have had in exploiting their intangible assets, and provides help to enable companies to identify key intangible assets.
www.innovation.gov.uk/projects/intangible_assets/index.html

Measuring Intellectual Capital – helpful guide from David Skyrme Associates, an independent consultancy, which looks at measuring intellectual capital, guidelines, and examples.
www.skyrme.com/insights/24kmeas.htm

ICM Group – impressive web site from this consultancy firm, which includes a full library of books, articles, white papers, and conference presentations. At the time of writing the intellectual capital resources comprise over 40 full text documents.
www.icmgroup.com

Intellectual Capital (Sveiby Knowledge Management) – useful resource including a brief history of the concept and a selection of full text articles.
The site also contains links to relevant documents, including their Intangible Assets Monitor.
www.sveiby.com.au/IntellectualCapital.html

Intellectual Capital: Tomorrow's Asset, Today's Challenge – visioning white paper from AICPA on intellectual capital, looking at issues for CPAs in the years ahead.
www.cpavision.org/vision/wpaper05b.cfm

More intellectual capital links are available from the ICAEW web site's links pages at: www.icaew.co.uk/library.htm

December 2001 Issue 82

Comments and suggestions should be addressed to Chris Jackson BA FCA, Head of the Faculty (see left).

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ABSTRACTS FROM LIBCAT

Baillieu W – Putting a value on know-how
Professional Investor, Vol.11. No.6. July/August 2001: p14-16 (3 pages)
● *The most valuable assets of every business are its name and reputation, its technical and product know-how, its staff and customers. So managers need to understand how to protect, manage, exploit and value those assets. The author is a director of Valuation Management Ltd and Intellectual Property Management Ltd, and he explains the process by looking at the due diligence stage and the valuation stage, and concludes by looking at price and value.*

Keegan M – Corporates raise the standard for the reporting revolution
International Accounting Bulletin, No.286. 30 April 2001: p8-9 (2 pages)
● *The authors report that it is time to take action on non-financial reporting and for corporations themselves to rise up and storm the barricades. The authors look at the PricewaterhouseCoopers' ValueReporting framework which has four key elements – market overview, value strategy, managing for value, and value platform – through which ValueReporting provides the company with a comprehensive way to evaluate and structure its communications to the marketplace. This article also appears in The Accountant, No.5969. April 2001: p14-15.*

Kothari D P – Developing a marketing strategy for global on-line customer management
International Journal of E-Business Strategy Management, Vol.2. No.4. May/June 2001: p301-305 (5 pages)
● *Even the most well-designed site must be marketed to get the regular inflow of new customers and be profitable in the long run. This paper illustrates why an awareness of the characteristics of on-line customers is imperative to the marketing process through Global On-line Customer Management .*

http://www.icaew.co.uk/library.htm

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Getting to grips with intellectual capital

In the Faculty's recent lecture, **Göran Roos** (*below left*), a founding member of the intellectual capital 'movement', was joined by Cranfield School of Management fellow **Joe Peppard**, in explaining how intellectual capital can be used both to measure and manage value creation in a business.

Göran Roos is chairman of London-based Intellectual Capital Services Ltd and visiting professor at the Helsinki School of Economics. Tel: 020 7694 6100; email: intcap@intcap.com; web site: www.intcap.com.

Joe Peppard is senior research fellow at Cranfield School of Management. Tel: 01234 754477; email: j.peppard@cranfield.ac.uk.

Göran Roos, an acknowledged expert on measuring and managing intangible assets (IAs), spoke first about the theoretical concept of measuring value, going on to discuss the implementation of value measurement.

There has been a growth in the relevance of intangible – compared with tangible – assets, he said. This has a sound basis. Intangible assets can be 'sweated' even more effectively than tangibles (eg making your brands profitable). Tobin's Q – the quotient measuring the difference between the market value and the balance sheet replacement cost – is increasing all the time. There is also the growing importance of the 'money-value-of-time' – shifting the emphasis to activities that do not have a long lead time.

Roos listed some of the characteristics of IA, such as:

- *non-rivalry* – they can be used simultaneously by different people in different places;
- *non-additive nature* – they do not proportionately diminish according to the amount they are used, nor increase in line with the amount invested in them;
- *network economic behaviour* – they show little return on initial investment, then an increasing marginal return, which later diminishes;
- *partial excludability* – it is difficult to protect them from external appropriation; and
- *information asymmetry* – they involve abnormal uncertainty, and are more easily 'known' by those within the company.

Four basic needs are addressed when dealing with intangibles, Roos went on, namely:

- does the company have sufficient amounts of the right resources (eg, competences, relationships) to guarantee value creation?
- is it deploying those resources effectively for generating value? An example of failing to do so might be to hire a much-needed tax lawyer but employ him solely in cleaning the MD's car;
- is it deploying them efficiently, creating the maximum possible value? This requires an understanding of what needs to be 'captured' to predict the change that a given resource is capable of effecting; and
- how can the company increase value for a particular stakeholder?

Roos defined five categories of business resources, each one having different characteristics. These were:

- *money* – owned and controlled by the firm, additive in nature, diminishing marginal returns, measured as real cash;
- *plant and machinery* – owned and controlled by the firm, additive in nature, diminishing marginal returns, measured as 'virtual' cash, since whatever their balance sheet value, the replacement and sale values will be different;
- *relationships* – owned and controlled by the other party, non-additive in nature, network economic behaviour, no one clear unit of measurement;

- *organisational resources* – processes, brands, intellectual property, written material etc, owned and controlled by the firm, non-additive in nature, network economic behaviour, no one clear unit of measurement; and
- *competences* – embodied in the organisation's people, who are not owned but 'rented', non-additive in nature, increasing marginal return, no one clear unit of measurement.

Distinction trees

Merely looking at organisational structure is not enough to get to grips with value creation. Hence, Roos stressed, it is important to build a 'distinction tree' (*see Figure 1, below*) around all the different kinds of resources possessed. This helps to establish – without double counting – those processes and systems of value to the business.

The exercise also allows the development of a language about resources, and an ability to judge whether the business has the right amount of the necessary kinds, and whether they are packaged so as to make money.

Measuring effectiveness

However, having a resource does not necessarily mean it is being used to create value. For value to be created, one resource must be transformed effectively and efficiently into another – ending in the monetary resource.

Measuring effectiveness is, therefore, an issue about capturing the value contribution of the transformation of relationship, talent, or whatever, into money. Although tools abound for measuring existing value and performance – most notably the balanced scorecard – they do not capture the value of the potential transformations.

A company needs to establish which of its resources – monetary, physical, relationship, organisational or human – it is mainly converting to value, to ensure it is measuring the right things. This is not always obvious.

For any company, a Navigator (*see Figure 1 in the case study, opposite*), depicting the real importance of a business's resources and transformations, helps in addressing issues of effectiveness.

Measuring efficiency

Having decided on your most effective resource transformations (be it sale of expert man hours, standardised solutions, relationships, physical products) it is important to measure the efficiency with which they are conducted.

To ensure that you are on top of the transformation criteria from start to finish, it is important to choose a small number of key indicators which are observable, measurable, and do not overlap.

Roos pointed out some important assumptions underpinning the IA perspective:

- *value is subjective* – so one needs to know what stakeholders expect as indicators of value; and
- *all IA are combinatorial* – they do not simply add up, with more of one capable of substituting for less of another.

However, despite its subjective nature value is just as 'hard' an issue as transactional accounting and can be measured, Roos stressed. But doing so is complex, and requires combinatorial mathematics. In the first instance, it is necessary to:

- identify the object under observation (unit, subsidiary, organisation);
- identify the stakeholder(s) for whom you wish to measure value;
- extract the relevant themes under observation;
- break those themes down into measurable elements; and
- design measures to make these elements comparable (eg, 'fruit' rather than the more element-specific 'apples' and 'pears').

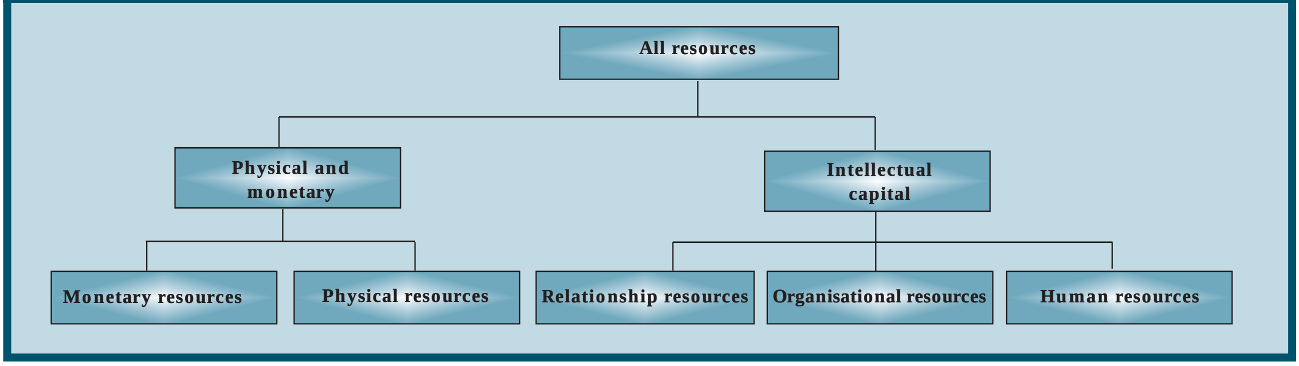
The measurement of the transformation itself involves finding how much of the possible value creation has been achieved, which dimension of change has the largest impact, what the trade off has been (ie, the payment, in terms of units of one resource given up for units of another), and converting the total value created into monetary terms.

The exercise then allows you to look at not just the value of the firm, but how much of that value comes from people, systems, customer relations, plant and equipment, and money in the bank.

In conclusion, Roos pointed out that intangibles nowadays count for between 45% and 70% of a company's assets, hence only by knowing the value added by its relationships, people, and ideas, as well as its plant and equipment, can its true value be measured.

These IA values, he said, are as assurable as tangibles, but more complex. Value accounting does work, it is scientific and academically accepted.

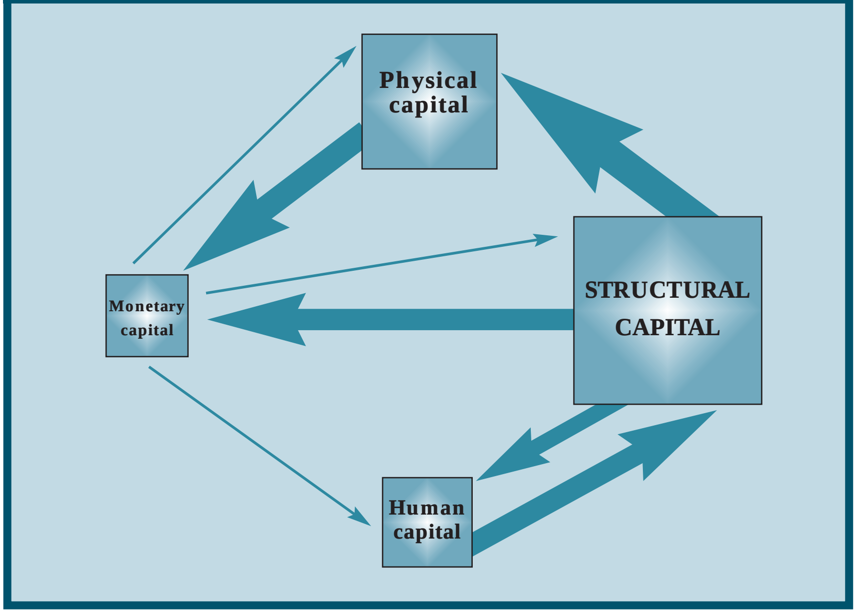
FIGURE 1 DISTINCTION TREE



Apion – a case study of IC theory and practice

In his contribution to the lecture, **Joe Peppard** focused on the mobilisation and management of intangible resources (in this instance, knowledge), using telecommunications software company Apion as a case study. Over a period of three years, by such means, Apion had increased its value from very little to conclude in 1998 with the realisation of $263 million for the sale of only part of its assets.

FIGURE 1 THE APION NAVIGATOR



Apion, Peppard explained, was established in 1995 as a Belfast-based subsidiary of Dublin software company Aldiscon. In 1997, Logica bought Aldiscon, and Apion was spun off as a separate company. Denis Murphy had taken over as Apion's CEO the previous year, when a staff of 20 was mainly involved in developing switching software. With the spin-off, Murphy was given the explicit objective of maximising shareholder value.

The strategy

His immediate action was to shift the company away from being service-based to one deriving its revenues from product license fees, since higher values are attached to product companies. The strategy was to become "a world-leading niche telecommunications software company by successfully utilising leading edge technology in the commercial exploitation of 'first to market' computer based network infrastructure components".

Despite having no idea what the products or services of the future would be, Murphy was confident that Apion could establish with some accuracy the technologies on which they would be based. He identified the knowledge, skills and core technologies underpinning the competences needed to compete in this marketplace.

The core technologies he identified were switching, signalling, wireless data, internet integration and convergence with telecommunications, billing, network management and intelligent networking technologies.

However, although convinced that software companies rather than traditional telecommunications ones would be the key telecommunications industry players over the next century, Murphy faced a problem in sourcing the necessary knowledge and skills, particularly in Northern Ireland. Having identified the knowledge gap, he therefore set about establishing a knowledge-building programme.

One element of this programme involved consciously choosing to collaborate with those in possession of the relevant know-how, for example working with Ericsson on a joint project on switching calls on digital networks, and with Siemens on a project involving signalling protocols.

Additionally, the company put in place a number of in-house knowledge-creating and -exploiting initiatives, including both training and rotation of staff between technologies and types of projects. It developed a specialised masters programme in telecommunications in conjunction with the University of London – with the central emphasis on adding intellectual rigour to the knowledge acquisition process.

Apion adopted the 'Investors in People' initiative. And, realising that the best developers do not always make – or want to be – the best managers, the company made it possible for employees to move up the pay scale while staying in development work.

A Technology Forum was also established, with employees rotating in membership, spending up to three months within it increasing their industry and specific knowledge. During membership, employees would spend 20% of their time on research and development, giving them the chance to meet the Forum's agenda of getting early visibility of possible product opportunities.

Murphy also tried to ensure an informal atmosphere, keeping an 'open door' policy to encourage ideas.

Adopting the IC process

Even so, Murphy still had anxieties because these changes were based only on a 'gut' feel. He was also frustrated that the traditional strategy process and model, along with Apion's management information and reporting systems, were proving inadequate in supporting his chosen strategy of building and leveraging knowledge. There seemed no framework for describing the strategy and no common language for communicating it.

Having heard of IC, he began to think that its emphasis on action and implementation might offer an appropriate perspective for Apion. In early 1998 he decided to take his management team through the IC process.

A series of workshops helped the management team prioritise their investments and business activities to achieve their strategic intent. In particular they worked on answering the first three of Roos's key questions:

- what resources were needed to create value according to the strategic intent?
- how should they best deploy these resources to create that value?
- how relatively important were the identified resources and transformations for achieving the strategic intent?

In response to the first, all resources – intellectual, physical, monetary – were identified and set up in a distinction tree. Given Apion's knowledge-based strategy, the focus was on identifying the different IC components – existing or required.

On the second, to define the value creating transformations of these resources, the team asked itself:

- what resources should be invested in to achieve the strategic intent?
- how to ensure that knowledge was created efficiently?
- what was most effective in terms of value creation? and
- what these transformations meant in operational terms.

The answer to the third question was achieved through assigning weights to the resources and transformations.

Apion's value creation path

The articulation of the value creation path is always an iterative process, involving large amounts of information about hidden assets deemed important to the organisation. Trade-offs for best value creation are essential to keep the strategic focus clear.

The finally agreed solutions to the above three main questions are depicted in the Navigator shown in

FIGURE 2 HARNESSING THE INTELLECTUAL CAPITAL

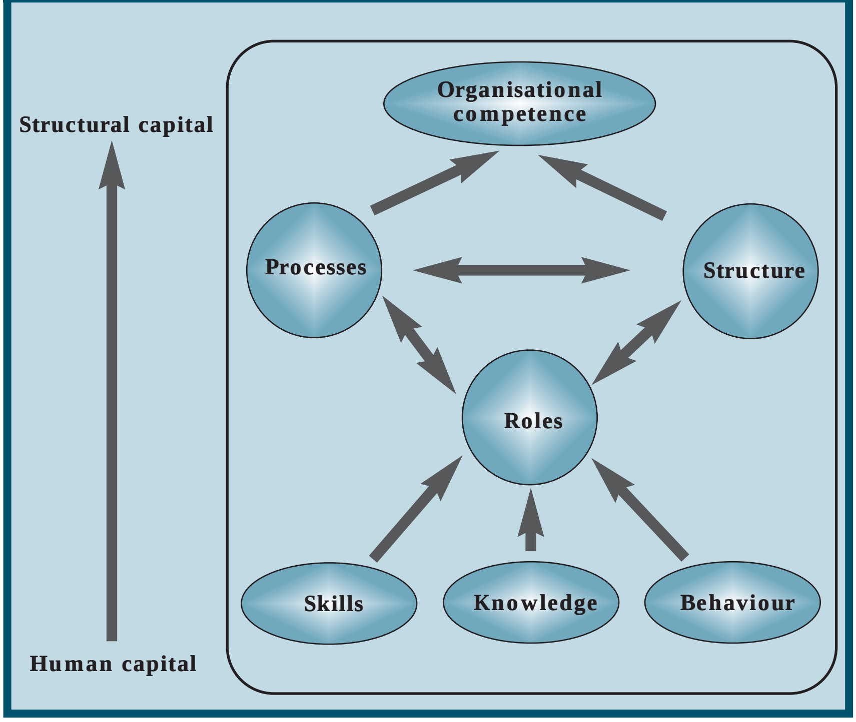


Figure 1 (*see previous page*). This represents the four forms of capital, the arrows between them showing the transformations, and the size of the boxes and the arrows indicating their relative importance to value creation. The small size of the monetary capital box does not indicate lack of interest in revenue, merely that the right knowledge, processes and systems, and leveraging them to create new products, are more important in the process of creating value for shareholders.

For Apion the most important transformation was from its structural capital (processes; procedures; manuals; databases – with their embedded knowledge; and relationships with customers and strategic partners) into the physical capital of its products. But there was also a transformation straight from structural to monetary capital – representing the intention still to create some revenues through selling customised solutions. The third transformation, showing a net outflow of human capital to structural capital, denoted the absence of any significant plans for sale of man-hours (eg consultancy), with the flow in the other direction – from structural to human capital – denoting individual's increased knowledge, as a result of working on projects and benefiting from the company's knowledge creating initiatives. (The thin arrows from monetary capital to the other three forms represent investment).

Insights from the process

Going through this IC process shifted Apion's perspective from considering people its most important resource to recognising that structural capital held that place. And it gave the organisation a true understanding of the importance of the transformation of resources in creating value.

Apion then set about converting the skills and knowledge of its employees into organisational competence, including defining employee roles (along with the behaviour expected therein), and giving individual employees more than one role – often to be performed simultaneously. This succeeded in harnessing the intellectual capital existing within the company (*see Figure 2*).

Realising shareholder value

The result was that Apion became the first company in the world to market a WAP gateway product in February 1999. Then, in October 1999, Phone.com made its $263 million offer.

Developing a way to show corporate value

Faculty member **David Phillips** of PricewaterhouseCoopers explains companies' and markets' mutual need for a more detailed exchange of information, the ensuing benefits, and how PwC's ValueReporting Framework assists in producing this greater transparency.

Ongoing PricewaterhouseCoopers research, focused on the global capital markets and across numerous countries and industries, confirms that significant communication gaps exist between the information companies currently report and the information the market wants and needs to value a company's shares properly.

What is ValueReporting?

The ValueReporting initiative is PricewaterhouseCoopers' view of how performance measurement and corporate communications need to be both aligned and significantly enhanced. This new approach seeks to help companies realise their full value in the capital markets by addressing the gaps between the current financial reporting model and the demand by investors and other stakeholders for more and better information.

Philosophically, ValueReporting presumes complete transparency. Whatever information management uses to run the company should be the basis for what it reports to the marketplace. This philosophy stands in stark contrast to the prevailing practice where most companies report only what regulation requires.

The need for a new reporting model

Financial information is important, of course, and ValueReporting does not seek to replace it. Rather, the ValueReporting Framework, described later, augments it. There is ample evidence to show that investors and other stakeholders want more and better information about what really creates value in companies – the market competitiveness, corporate strategy, and the intangible assets and non-financial measures that are lead indicators of future financial performance.

The significance of ValueReporting

To understand the importance of ValueReporting, it may help to consider the 'value continuum'. Companies create, preserve and realise value (*see Figure 1, below*).

ValueReporting focuses on value realisation – what the management team does to make sure the company's stocks are properly valued, such as reporting all the information that the market really wants.

If management considers certain non-financial information important in running the business, it is likely that investors and other stakeholders will find the same information equally important in valuing the business. Our research confirms this. Furthermore, the leverage on the share price of getting the value realisation process right is enormous, and managements need to consider whether they are investing enough resources to get this job done.

Why the markets need ValueReporting

The need for ValueReporting derives principally from three factors. First, it is fairly clear that traditional valuation methodologies simply don't work very well any more. Whether it's P/E ratios, price to sales ratio or other measures, the traditional rules of thumb that people use in making investment decisions fail to provide the type of decision making information that investors are demanding.

Second, the markets need ValueReporting to try to reduce the extreme volatility that exists in stocks today – a certain proportion of which is created by a lack of information. A third, more subtle, reason is the high concentration of value in capital markets, meaning companies have to work harder to get themselves seen.

The information investors want

Over the past few years, we have been conducting research to identify just what information investors want and need beyond traditional financial reports. The good news is that the capital markets are global when it comes to the need for management information; country by country their needs are the same.

Our subsequent research continues to centre on specific

FIGURE 1 THE VALUE CONTINUUM

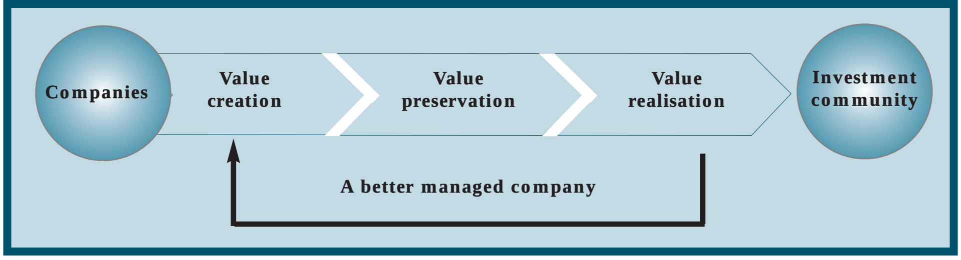


FIGURE 2 LEAD INDICATORS OF PERFORMANCE

External	Internal		
Market overview	**Value strategy**	**Managing for value**	**Value platform**
● Competitive environment ● Regulatory environment ● Macro-economic environment	● Goals and objectives ● Organisational design ● Governance	● Economic performance ● Financial position ● Risk management ● Segmental performance	● Innovation ● Brands ● Customers ● Supply chain ● People ● Corporate reputation

industries. Such research evaluates a customised set of performance measures in terms of their industry-specific importance to companies and the market, the quality of information, the systems companies use to produce information, how well managers think they are doing in communicating, and the market's satisfaction with the quality and quantity of information it receives.

While space does not permit extensive discussion of our research here, some basic findings are consistent across industries studied to date including:

- companies' corporate disclosure practices are often inadequate;
- substantial communication gaps exist in reporting on some of the most important performance measures; and
- there are significant benefits to improving corporate disclosure.

Furthermore, the research showed that, in every industry, both executives and investors placed a greater number of non-financial measures in their lists of the most important measures than they did the traditional financial measures that appear in the required financial reports.

The ValueReporting Framework

Based on the extensive research programme, we have developed the ValueReporting Framework. This framework is a real working model which is tailored to reflect the unique performance dimensions of specific industries, enabling companies to communicate their value in a language that investors understand. This includes management's view of the market place, its strategy for competing, its targets and objectives and the assets – both tangible and intangible – that the company considers critical to its success.

The framework builds on a number of underlying principles, the key being transparency. It assumes that shareholders come first, but recognises that long term sustainable value is realised only if the needs of all stakeholders are properly understood and managed. The ValueReporting Framework addresses four critical elements:

- *the market overview* – a clear explanation from management's perspective of the industry dynamics and market positioning;
- *value strategy* – the depth and clarity of strategy;
- *managing for value* – how companies manage their financial resources from an economic and risk perspective; and
- *value platform* – the critical activities and relationships which underpin value creation. The areas of business activity which are lead indicators of future financial performance (*see Figure 2).*

A closer examination of each of these four categories provides additional insight into how companies can put ValueReporting to practical use and begin to reap rewards. In order for a company to paint a comprehensive and coherent picture of its business, management must provide sufficient information within each of the four categories. In all cases, the four categories build off one another. Management's challenge is to integrate all its value relevant information and communicate that information consistently across the framework.

Greater transparency

Each year we publish the ValueReporting Forecast – a document which showcases the best examples of corporate reporting from around the world in the context of the ValueReporting Framework. This document and the research that underpins it highlights the fact that ValueReporting exists today. It also reveals the significant opportunities that exist for all companies to enhance the quality of their value related reporting. The reasons why companies are experimenting and making significant additional disclosures are numerous but the principal reasons are as follows:

- the need to close a real or perceived value gap;
- to respond to a crisis or discontent either in the capital markets or amongst other stakeholders;
- to demonstrate strong governance;
- to display a commitment to corporate social responsibility; and
- to gain competitive advantage.

Finally, for a number of companies, the reason is a visionary leader, someone who understands today's business environment and the importance of transparency and stakeholder engagement.

More information on the above can be found at www.valuereporting.com.

David Phillips is a partner with PricewaterhouseCoopers in the Assurance/Business Advisory practice in the UK and serves as the European Leader of ValueReporting. He is co-author with Robert G. Eccles, Robert H. Herz, and Mary Keegan of The ValueReporting Revolution: Moving Beyond the Earnings Game, published by John Wiley & Sons, March 2001. Price £21 (purchase details on www.valuereporting.com).

LAW **UPDATE**

The long process of revamping company law

In the first of a planned regular series of Updates on legal issues affecting accountants in finance and management, **Sarah Robinson** looks at the latest proposals for modernising company law.

Sarah Robinson is an assistant solicitor in the corporate department of international law firm DLA.

On 26 July 2001, the Company Law Review Steering Group published its 'Modern Company Law for a Competitive Economy: Final Report', recommending fundamental changes to company law. Many aspects of company law are implicated and, if implemented, the changes will *inter alia* herald a significant degree of deregulation for many companies.

This article focuses on those proposals which may be of particular interest to accountants in management. However, given the extent of the proposed reforms, it is unlikely that any new legislation will be in place before 2003 at the earliest.

Small company accounting regime

Based on a stated policy of 'think small first', the steering group envisages that small and private companies should no longer be exposed to regulation which is of more relevance to the requirements of large publicly owned companies.

In particular, the steering group recommends increasing the relevant turnover and balance sheet thresholds to allow more companies to take advantage of the small company accounting regime, simplifying the format and content requirements for small company accounts and raising the threshold below which companies are treated as being exempt from the requirement to have their accounts audited. It is further proposed that the time limit for private companies to file accounts be shortened to seven months after the financial year end.

Independent professional review

For those companies which would be able to take advantage of the extended small company accounting regime but which have a turnover that, based on present thresholds, prevents them from being exempt from audit requirements, a more controversial proposal is the replacement of the audit with a lesser form of assurance known as an independent professional review or IPR. The IPR has been considered by the Auditing Practices Board, which reported its findings to the DTI in November. The IPR is not, however, supported by those chartered accountants who believe that public confusion will be created over the level of assurance which the IPR provides.

Reporting

The steering group recommends that most public companies and very large private companies publish an operating and financial review or OFR as part of the annual report. This reflects what is increasingly becoming market practice and is driven by the aim of promoting accountability, transparency and generally improving the quality of information provided to creditors and shareholders. The OFR would be forward looking to a degree and would provide a review of the business, its performance, plans, prospects and other information which the directors judge necessary to understand the business.

The steering group proposes that quoted companies should be required to publish their annual report and accounts on a web site within four months of their financial year end. There should then be a holding period of 15 days in order to allow time for shareholders to table resolutions for the forthcoming AGM. All public companies would be required to lay and file accounts within six months of their financial year end.

Auditors' liability

The steering group has taken the concerns of auditors into account by proposing to adopt a more reasonable regime concerning their potential liability. This is particularly significant in the light of proposals to widen the role of the auditor to encompass the audit review of the OFR. Contrary to current company law, auditors will be permitted to limit their liability contractually with the company and, in tort, with third parties, within limits set by the Secretary of State and subject to prior shareholder approval. It is proposed that there should be no statutory extension of the auditors' duty of care and directors and employees should have wider statutory duties to assist auditors.

Implementation

The above proposals represent only a small number of those contained in the Final Report. Others include a statutory statement of directors' duties, reform of the rules on maintenance of capital and new formation procedures. The government has yet to issue a substantive response to the proposals and consultation on new legislation is likely to be drawn out.

HUMAN FACTORS **UPDATE**

How to put a price on people

Valuing the management of a targeted company remains a thorny problem for would-be acquirers. **Miranda Kennett** of the Management Due Diligence Company describes a formula to solve this problem.

Miranda Kennett is founding partner of The Management Due Diligence Co. Tel: 020 7412 0016; email: mkennett@mddco.com.

What is the value of the management in a target company being considered for merger or acquisition? One rule of thumb puts it at 40%. However, this could be much higher in businesses heavily reliant on their people – eg media and entertainment companies and the service sector in general. The question then is: how can we reliably tell whether the management is a valuable asset, a liability or a problem waiting to explode?

Acquirers often ask the accountants and lawyers who provide due diligence to give their impressions of the people they have met. And venture capitalists have their own informal methods of establishing management value, often involving 'trial by dinner'. Checking references has also been common practice, though this also has its drawbacks in that the information is a rear-view mirror of what they've done in the past and generally comes from someone they can rely on to say nice things, rather than from any objective source.

It is not surprising, then, that in recent years finding a robust and reliable means of evaluating managements, particularly prior to an investment or merger, has become a subject of increasing interest and there are now several firms offering management asset evaluation.

Methodologies vary but most companies use a combination of psychometric profiling and more qualitative approaches. Services offered by executive search companies often use consultants to assess the management team and their valuation is based on comparative market value measured against others in the sector.

Future ambitions

But there is a different way of approaching this issue which involves working first with the acquirer (or the designated CEO of merging entities) to establish what the future ambitions are for the business. That way, when evaluating the management team, it is possible to assess whether or not they are fit for the task ahead, as opposed to their competence in fulfilling the expectations of the past. Also, it is possible to discern whether the team, as a whole, has the skills and attributes required for future success.
The Management Due Diligence Company uses the latter methodology. Its assessors are also coaches and are adept at getting under the superficial gloss any would-be acquisition can paint on to the reality of the business. They regularly turn up what's really going on beneath the surface which will impact on future performance. Sometimes they discover deep enmity between partners who superficially appear to get along. Sometimes they find talented people in the wrong job, who could be valuable if ttransferred to a different role.

Where two businesses are merging, it is essential to be able to judge how flexible the key players are and, therefore, how likely it is that they will be able to adapt to a new team with a different configuration and a more ambitious business goal.

No vested interest

Of course, objectivity is of prime importance. Because practitioners of this latter approach are not dependent on success fees, and have no vested interest in the deal going ahead, they are able to give the bad news, if necessary, and thereby prevent clients from wasting investment capital. To take a real-life example, last year in the valuation of a fledgling e-commerce business, it emerged that, despite a compelling idea, an extensive business plan and two highly charismatic leaders, the management team had low levels of commercial awareness and was unlikely to make its plans work. The investment did not proceed.

If such evaluation has yet to become the norm, it is perhaps because of a nervousness on the part of investors at the idea of a third party coming between them and their quarry. This is understandable when beauty parades abound. However, because effort has been put into making the service valuable to acquired as well as the acquirer, clients discover that the process actually produces enhanced perceptions of them as acquirers.

Showing an interest in the people and making sure the company has the team in place that will take it to new heights are seen as positive features. Having an experienced outsider to help you think about your own performance and what you want out of the deal is also regarded as a very helpful (and unusual) benefit.

FORTHCOMING FACULTY EVENTS – 2001/2002

To attend any Faculty event, please fill out the form which adjoins this page, remove it by tearing along the perforation, and mail it or fax it to Kirsten Fairhurst at the Faculty's address given on the bottom of the form. If you have any queries relating to these or other events, please contact: Kirsten Fairhurst on 020 7920 8486.

- 4 December BREAKFAST SEMINAR (Lancashire Cricket Club, Manchester)

'BUDGETING AND PLANNING FOR THE 21ST CENTURY' – JOHN MCKENZIE, ARMSTRONG LAING.

This seminar looks at the increasing inability of budgets to deliver, and explores ways for companies to develop more dynamic budgeting processes that go beyond numbers and tie in with the way businesses consume resources whilst still providing appropriate controls in today's changing business environment. Registration/breakfast 8.00am; seminar 8.30am-10.00am.

- 28 January EVENING LECTURE (Chartered Accountants' Hall, London)

'MANAGING THE CHANGE – PERFORMANCE MANAGEMENT IN THE PUBLIC SECTOR' – ANTHONY DART, BUSINESS CONTROLLER, HIGHWAYS AGENCY.

Skills in financial management, rather than financial reporting, are vitally important in the public sector. Anthony Dart, former technical director at CIMA, explains the changes he has made to the planning and implementation system at the Highways Agency and discusses the future of the finance function in a large organisation. Registration 5.30pm; lecture 6.00pm.

- 18 February EVENING LECTURE (Chartered Accountants' Hall, London)

'VALUEREPORTING – A REVOLUTION?' – DAVID PHILLIPS, PRICEWATERHOUSECOOPERS.

This lecture looks at some of the issues raised by David Phillips in his article on page 7 of this issue, including the information that investors need, how to manage for value and the benefits of greater transparency. Registration 5.30pm; lecture 6.00pm

RECORDINGS OF FACULTY LECTURES

The following lectures and conferences held by the Faculty in 2001 are available, in both **audio** and **video** format.

To obtain a recording, please tick the audio and/or video box on the tear-off response form opposite.

There is a charge of £5.00 for audio recordings and £10.00 for video.

COMPETING IN THE NEW ECONOMY
David Asch of the Open University Business School considers some fundamental aspects of customer choice in the new IT environment.

DYNAMIC STRATEGY
Mark Thomas of PA Consulting illustrates how companies which adopt this approach can obtain superior returns for their shareholders over the long term.

BEYOND BUDGETING (HALF DAY CONFERENCE)
Robin Fraser and **Peter Bunce** of the Beyond Budgeting Round Table CAM-I Inc illustrate how to manage performance better without budgets – plus a contribution from **David Berkeley** of Bulmers.

THE BALANCED SCORECARD
Robin Bellis-Jones of Bellis-Jones, Hill & Prodacapo shows how the balanced scorecard has enabled the vision of a strategy-focused organisation to become a reality.

BUDGETING AND PLANNING FOR THE 21ST CENTURY
John McKenzie of Armstrong Laing explains the increasing inability of budgets to deliver, and explores ways for companies to develop more dynamic budgeting processes.

Exploring shareholder value creation

The Faculty's one-day conference on 'Shareholder Value – from measurement to management' attracted a large audience, and covered the subject of value creation from many angles. **Helen Fearnley** reports.

The Faculty is planning to publish a full description of this conference and the ideas discussed at it as part of the Good Practice Guideline *series in 2002.*

The conference was opened by **Paul James**, speaking from the investor's perspective. James is founder and managing director of Sharevaluer, a specialist in investment data and tools whose clients including Reuters, Datastream and Thomson Financial. He argued that the core component of shareholder value is relative long term share price, that the key to adding shareholder value is to grow the share price relative to investors' alternative opportunities over the medium term, and that that share price growth is achieved by managing the main driver of price – expected future performance.

Next up, **Matt Davies** and **Paul New**, of the ATC consultancy, looked at value measurement from the corporate perspective. They analysed the 'alphabet soup' of new value measures available, pointed out their relative strengths and weaknesses, and indicated for which sort of corporation each was best suited. They gave examples of well-known companies' success – or otherwise – in creating shareholder value using a given metric. Then New, who was previously marketing director of McVitie Prepared Foods, within United Biscuits, described that group's mixed experience (1995-2000) of using ROCE as a short-term measure to improve its ability to create value for shareholders.

John Good, head of value based management (VBM) at Cadbury Schweppes, then gave a practitioner's perspective on using VBM tools and techniques. He described everything that Cadbury Schweppes has done to produce an integrated programme for managing value, how rewarding this has been for the group, and how it is proving an evolving project even after four years. Particularly important, he said, has been the buy-in of chief executive John Sutherland.

In the final morning session, **Robert Sharp**, a project manager for BAE Systems who is also studying for a PhD – in which his research includes 'How ideas spread within organisations' – produced some thought-provoking questions on the nature of VBM. He reflected on what VBM actually is, the forces – converging, diverging, and resisting – influencing its adoption (or not) by the business community, and the very different styles used for its implementation. He even, disturbingly, questioned whether managers are able to represent the interests of their shareholders and whether shareholders actually want managers to manage for value. He suggested that 'lean management', with its focus on elimination of waste, was an easier concept to drive down through an organisation, producing similar results to VBM.

The afternoon session included a more audience-participatory exercise, presented by **Simon Court** of Value Partnerships – consultants who work with companies to implement value creation strategies. Again the focus was on the internal perspective of how to organise and manage value creation. This he did, having provided the frightening statistic that 70% of all change initiatives fail, adding that, in his view, shareholder value initiatives are no exception unless intelligently handled.

Gordon Clark, managing director of Keppler Associates, completed the day's proceedings (bar a final, fascinating question and answer session) by looking at reward systems for value creation (Keppler Associates' speciality). He gave a detailed analysis of the advantages and disadvantages of the various systems of reward, looking at every possible facet of such schemes' design, methods of measurement, and process.

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