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Management Quarterly

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Management Quarterly

A new way to keep ahead

Management Quarterly aims to deliver the basic building blocks in core management disciplines. It is produced in association with Cranfield School of Management. Each issue will contain articles on Strategy, Human Resources, Marketing and Finance, with other occasional subjects such as Project Management and Knowledge Management. Over a three year period this will build up to a comprehensive overview of practical business knowledge, and modern management ideas.

Management Quarterly will:

- Provide a comprehensive grounding in the knowledge needed to operate a successful business.
- Enable the reader to understand current issues and debates in these areas, and distinguish core ideas from current fads.
- Provide a wide ranging programme of CPE suitable for members both in business and advising businesses.

Key points

- Each part will be self standing and include recommended further reading.
- Writers are selected from Cranfield School of Management, other leading business schools, and practitioners.
- Experts in each field explain and discuss the relevance, practicality and usefulness of key new concepts and ideas, thus enabling the senior executive to keep really up-to-date.
- A message board is available on the Faculty internet site.
- Chartered accountants often have limited reading time. *Management Quarterly* is succinct and the writers will direct the reader to other, and often fuller, expositions on the subject. The program is no substitute for an MBA but it will follow some of the major threads on an MBA.

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Management Quarterly
is compiled and edited by Ruth Bender.

Executive editor: Chris Jackson

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STRATEGY

PART 2 CORPORATE STRATEGY

Philip Davies, Cranfield School of Management

This second article builds on the first by outlining what corporate strategy is, describing some of the key terms used and how such concepts are applied in practice, and then illustrating these concepts by means of a case study – the sale of Rolls Royce Motor Cars by Vickers in 1998.

What is corporate strategy?

Corporate strategy is about how to deliver value to shareholders, usually expressed as achieving above average industry returns, through being a good parent to the businesses that make up the company and through divesting those that cease to provide value while acquiring or growing businesses that do. Those responsible for corporate strategy are the CEOs and the executive directors supported by various specialist functions at the centre as well as in most, but not all cases, the CEOs of the component business units. Corporate strategy in theory is what the corporate centre does. However, corporate strategy in practice is a complex and uncertain process. On balance, research has shown that corporate strategy often destroys rather than adds value, while achieving above average returns is self evidently not sustainable by all firms all of the time. Corporate strategy, more than business unit or competitive strategy, is profoundly affected by factors outside management control such as changes in government policy and international relations, hostile takeover bids, exchange rate volatility and stock market sentiment. For example, engineering shares in the UK are undervalued compared to similar stocks in America. In consequence, a leading UK firm, Lucas Varity, considered moving its share listing to New York. There are also fashions in corporate strategy: at times conglomerates with portfolios such as Hanson are viewed as the answer, while at other times firms are urged to 'stick to the knitting' and focus on core competences. Institutional shareholders themselves are often puzzled by what companies are up to and retain long memories of when they were let down when a particular acquisition went badly wrong. In consequence, a CEO of my acquaintance sees his strategy as simply exceeding the expectations of stock market analysts!

What are the roles of the centre?

The three roles of the corporate centre are:

- To administer existing businesses;
- To try to develop new ones;
- To act as a steward or agent for those who have financed the businesses – the owners who are the shareholders.

A lot of what the centre and the directors do therefore is either prescribed or is purely administrative. Directors' roles and responsibilities for example are laid down in law. For example, they are expected to disclose outside interests. A considerable amount of time is thus spent on activities which may not appear to be value adding such as external relations, dealing with journalists and in managing relationships with government and other firms. Yet such activities are important to the smooth functioning of the enterprise because they need to be done and it is better to centralise them and so free up the businesses to focus on serving customers. Indeed the centralisation of functions to achieve economies of scale – eg marketing or R&D – is a classic argument for responsibilities to be managed at the centre rather than at divisions. There is also a difficulty in agreeing a disposal policy with the participation of those about to be disposed!

How does the centre deliver corporate strategy in practice?

In theory the centre could be just a small team with excellent information systems – indeed some are run like that – but in practice centres do tend to grow in line with Parkinson's Law that work expands to fill the time available, while bureaucrats make work for each other. Chief executives also like to control activities which are vital, so will have centralised finance functions at the very least. The trend though is to outsource where practicable or to make departments cost centres who then market their services to businesses. This cost centre model has been extensively applied by, among others, Asea Brown Boveri (ABB), and is also seen in public sector reforms in the UK, New Zealand and the United States.

How the centre carries out its role in terms of what departments are set up, or the roles of the directors, also depends on the type of industry and the structure of the firm. Thus the HQ of a global petrochemical company who needs excellent governmental relationships will have different functional departments to a national retailer where purchasing is more important. Increasingly, there is a need to manage knowledge at a corporate level to ensure that learning is transferred around the organisation in global firms(Nohria & Ghoshal, 1997).

Corporate strategy styles

There are five distinct corporate strategy styles: planning; banker; strategic; broker; network.

- **Planning** In a planning style all important decisions are taken at the centre, which adds value through economies of scale in, for example, purchasing. This style fits a business type such as retail – for example, Marks & Spencer. There are problems with flexibility and the centre is large.
- **Banker** In a banker style the centre adds value acquiring poorly performing companies, stripping out their assets and managing those that are left for cash. This fits mature industries operating in declining or mature markets. An example of a successful firm in this sector is Hanson. The banker style centre is very small and may depend too much on a few key individuals.
- **Strategic** In a strategic style, the centre seeks to add value by transferring learning between the businesses and leveraging core competences. An example here is a multi national corporation such as BT. The centre can become large and there are problems with speed of decisions especially if a matrix is in place.
- **Broker** In a broker style (sometimes termed virtual), the centre puts together combinations of people and firms for specific projects. This fits dynamic industries such as film, or, increasingly, consultancies. The problem with this style is developing cohesion and a sense of purpose among the diverse groups.
- **Network** In a network style there is no distinct centre, rather power moves to where it is most needed. The executive are very mobile and have no fixed base. ABB seems to resemble a network organisation.

As always in practice, companies will display a variety of styles, and hence of structures. The important point is whether they fit the needs of the businesses. Every now and again, especially if the firm has been successful, cost cutting is necessary to prevent ossification.

What determines divestment and acquisition strategy?

Corporate strategy needs to ask twp questions in terms of its divestment and acquisition strategy:

- Is there a strategic fit between the aspirations of the business unit and the corporate vision?
- Can the centre support the needs, for capital or market entry, etc of the business unit?

If both questions are answered in the affirmative then the business unit will add value; if not, then its retention will destroy value and it will be better off elsewhere. This may be illustrated in practice:

Vickers plc and the sale of Rolls Royce Motor Cars

Vickers is a defence and engineering firm with a proud history dating back to 1828. It pursued a diversification strategy up to the early 1990s financed largely from defence, but the end of the Cold War and its impact on defence and a collapse in Rolls Royce sales resulted in a share price drop and demands from the shareholders for change. A new top team was appointed and, with additional capital from a rights issue, stated that it wanted to refocus the company. An analysis of the businesses took place and it was clear that while RRMC and Vickers' associated automotive businesses were good businesses, they did not fit because the investment needed was more than the parent could afford while its market area of luxury cars and racing sat uneasily with the high tech engineering image that was being projected to the market. A better parent was an automotive company. The decision to sell was taken but the timing of the sale was accelerated by a hostile takeover bid from Mayflower. Eventually VW bought RRMC and Cosworth Group (less Racing which went to Ford), although the Rolls Royce brand was bought by BMW due to the exercise of a veto by Rolls Royce Aero Engines. Everyone seems to have benefited from the sale. Cosworth Racing is said to be happier with Ford while Vickers has a war chest to continue its growth into the highly profitable marine and propulsion sectors.

Summary

Superficially, corporate strategy looks simple but while the decisions are limited in scope – buy or sell, grow or manage for cash – the practice of corporate strategy is extremely hard. Closing a factory is never a pain free exercise and taking a top team through the roller coaster of change and more change can be too much for some. The key qualities of an executive group, apart from a first class finance director, are courage, determination and a willingness to be flexible while maintaining the confidence in each other and the overall vision.

Questions

- What type of style is the centre for my business? Does it fit the structure and the needs of the business? Is speed of decision making a problem?
- For each business unit, ask whether there is a strategic fit with the strategy of the company and whether the parent can support the needs of the business.

If any reader wants to discuss any of the issues raised in this article, please e-mail the author at p.n.davies@cranfield.ac.uk. In our next article David Faulkner of Oxford University will look at Strategic Alliances.

References

- ***Competitive and Corporate Strategy***

  Bowman, C and Faulkner, D, Irwin (London, 1997).

  We use this as the MBA textbook on corporate strategy and it is excellent in outlining the factors which executives take into account when making decisions such as make or buy, acquire or seek partners.
- ***Managing the Multibusiness Company***

  Goold, M (ed) & Sommers Luchs, K, Routledge (London,1996).

  This is a collection of essential articles that consider, from different viewpoints, key issues in corporate strategy, such as corporate parenting as well as transaction cost economics.
- ***Parkinson's Law***

  Northcote Parkinson, C (1979)

HRM

PART 2 THE ROLE OF THE HR FUNCTION

Veronica Hope Hailey, Cranfield School of Management

The role of HR has changed significantly over the years. We look at how HR managers, and senior and line managers, interact on HR issues. Strategic and tactical models of the HR function are considered.

Introduction

I often start an MBA class, or an executive development workshop, by questioning students about the reasons for the increasing importance of the strategic management of people in Western economies at the end of this century. Most of the students/delegates easily put forward a strong and convincing business case for the competitive edge that can be derived from excellent people management in a service or knowledge economy and in the rapidly changing world in which businesses now operate. However, if I then go on to ask them their views of the personnel or human resources (HR) function there is a veritable flood of responses, often negative in content. These replies may include the following remarks:

- *'It's marginal, on the sidelines . . .'*
- *'How can you prove what its contribution is to the bottom line?'*
- *'The department's full of bureaucrats – all they ever ask us to do is fill in forms'*
- *'It stops us getting on with our jobs . . .'*
- *'Recruitment takes forever . . .'*
- *'It changed its name to human resources but nothing else changed . . .'*

Of course, in many cases that is what people have experienced when they've been in contact with the personnel/HR function in their employing organisations. However, in recent years, the more senior the manager, the more aware they are of the potentially valuable contribution that a strong HR/personnel function could make to the strategic agenda. What they want to know is how to release that potential to make it a reality. But first they must assess the current role and capability of the function within their own organisation.

Understanding different roles and capabilities

In order to understand a function's current role and capability, a manager needs to understand how personnel has evolved over the twentieth century. *Figure 1* plots the various stages of development. This life cycle model of personnel/HR describes how the function has evolved, but could equally track the department's development as a business grows. Each stage is examined in turn.

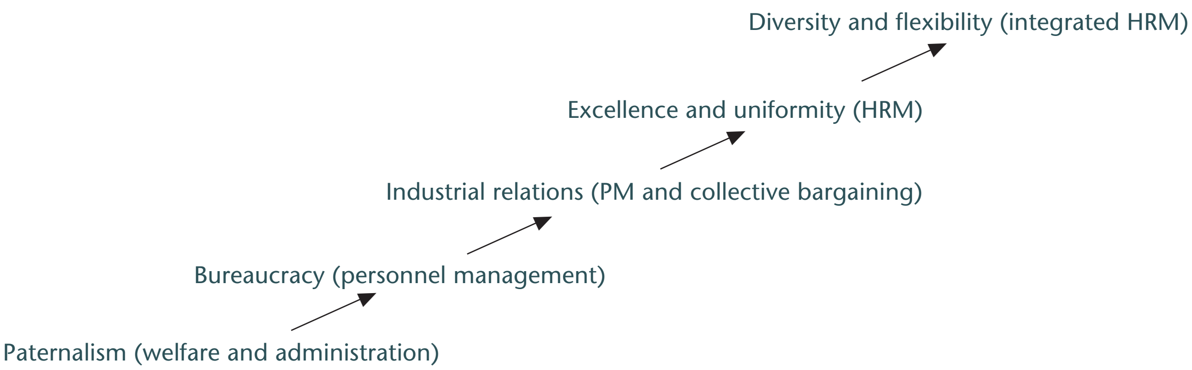

Figure 1 Evolutionary model

- **Paternalism – welfare and administration** The personnel function's roots in the UK lie in welfare. The first personnel officers appointed were often within factories owned by paternalistic owners who, for a variety of religious or philanthropic motives, wished to provide some level of support for their employees. The organisation that evolved into today's Institute of Personnel and Development was originally named the Institute of Welfare Workers. These people would offer a low level clerical service such as the administration of payroll, and organise welfare/social activities such as pensioners clubs or sports facilities. Many organisations, small and large, still practice this form of paternalism today. Within such firms the responsibility for people management lies with the line managers – recruitment and selection of staff, basic appraisal of performance or allocation of rewards or training. However, how those line managers practice people management is entirely ad hoc and dependent on the individual style of the manager concerned. Some may be good people managers, others not. The key is that they are not assessed or necessarily rewarded for good people management. The results can be either positive or negative as the process is not managed. Some paternalistic organisations may engender strong feelings of loyalty within their staff . In others the lack of standardisation of line managers' styles may become a problem as staff complain about the unfairness of the inconsistency of the treatment they receive. What may also happen is that as a business grows the line managers become overwhelmed by the demands of recruiting or appraising staff. For these reasons, consistency and line managers' time, the organisation may decide to invest in a personnel management function.

- **Bureaucratisation – personnel management** A personnel department will start to create standard policies and practices for the various formal activities associated with people management - selection of staff, appraisal systems, grading structures. However, what may also happen at this stage is that people management becomes associated with these formal policies and procedures and the informal everyday activities of managing staff get lost in the entrails of the staff handbook! Some commentators have called this the abrogation of responsibility for people management by the line. Instead, accountability for people is gradually thought to reside within the personnel function. Rationally, it seems to make little sense to ask a department which is often marginal and understaffed to take on responsibility for everything to do with managing and motivating staff – yet in some organisations this is what happened over time. Personnel officers or managers with special expertise in certain areas such as psychometric testing or management development have a valuable contribution to make but they cannot take on the everyday care of managing employee expectations. Furthermore, the function often lacks representation at a strategic level, and has little power or influence amongst senior management. However, this is not to downgrade the importance of core personnel management activities. The systems and procedures established by personnel managers are important in creating an infrastructure for the firm, much like information systems. For instance, it is much easier to manage change if the organisation has an effective performance management system.

- **Industrial relations – personnel management and collective bargaining** A third stage, that may or may not occur, is the establishment of specialist industrial relations departments. Collective bargainers have a real skill but research showed that whilst they were respected for their competence in this area they were often excluded from the strategic decision making of the firm. Their role was one of maintaining good employee relations whilst other managers got on with the critical issues of business direction. Again, whilst many deride the tradition of collective bargaining, there is much to be said for the efficiency of dealing with representatives of the workforce – communicating on an individual basis with employees of an organisation is much more time consuming and costly as many firms have discovered in recent years. This third stage in the development of people management was called in to question in the early 1980s when the shift from manufacturing to service economies contributed to the decline in trade union representation. Simultaneously, a new movement emerged: human resource management.

- **Human resource management (HRM)** HRM emerged from the USA in the early 1980s. It was influenced by both the research conducted on Japanese firms at that time and also by a best selling text *In Search of Excellence* by Peters and Waterman (1982). Whilst different models of HRM were developed, they all shared certain characteristics. HRM models argue that responsibility for people management lies not with the personnel function but with the line manager. However, this was not to be a return to the paternalism outlined above. Each organisation should seek to inculcate a standardised approach to people management amongst its line managers – people management was too important in a service economy to be left to the mercy of the individual whims of line managers. Instead, organisations strived to promote certain management styles which their line managers could then be trained and developed to enact and in turn assessed and rewarded according to their ability to perform. (Some observers equated HRM with the management of managers.) Key outcomes were to be greater flexibility amongst the workforce, higher levels of commitment and a concerted effort to promote quality issues.

  The function itself was to be changed. First, HRM argued that senior HR managers should be given board level positions in order that HR strategy could be integrated with business strategy. Secondly, a new breed of personnel officer or manager emerged – the generalist. Whilst the specialist personnel officers, the recruiters and selectors or the compensation and benefits experts, remained within the HR department, generalist HR managers were assigned to work alongside line managers within the business units, often with dual reporting lines into both the HR director and the business unit's director. These people were to act as a linchpin in translating the needs of the business into the specialist policy experts and, in return, helping the business to implement new personnel management procedures or initiatives. Thirdly, there was greater attention to managing the informal aspects of organisations – culture, style and climate.

The transition from personnel management to HRM was fraught with difficulty. It is virtually impossible to change decades of tradition by changing the name of the department from personnel to HR. Furthermore, many of the old style personnel managers were elevated to HR director positions but lacked the experience or expertise to offer a significant contribution to the strategic debates. In addition, many line managers were found to be lacking similar levels of expertise or experience in the everyday management of people. What looked highly desirable in the HRM models proved to be harder to achieve in practice.

Nevertheless, in the last fifteen years, many organisations have managed to shift towards this new approach to managing people. The models have become more refined and senior management recognition of the importance of HR as a strategic partner has increased. The education and training that some HR/personnel staff receive has become more commercially focused, and in the major multinational corporations HR directors are concerned with delivering HR and people management in flexible and diverse ways in order to meet the strategic demands of the business. In turn there is more emphasis in promotion decisions on a manager's people management abilities and high potential or fast track staff are expected to demonstrate some understanding of how to manage the human capital of a firm strategically.

The agenda for the 21st century

As we have seen, the agenda for the HR function has radically developed from its welfare roots at the beginning of the 20th century. One US commentator, Dave Ulrich, has put forward a matrix describing the four major roles for the function - see *Figures 2* and *3*. He argues that all four activities – strategic partner, change agent, employee advocate and administrative expert – are vital for an organisation truly to compete in a world economy. However, he also argues that individual firms may choose to allocate those roles to different management functions. For instance, in Hewlett Packard, the employee advocate or champion role would be seen to reside firmly in the line. The change agent role may be performed by specialist organisational development departments within or outside the HR function. Some firms may choose to outsource parts of the administrative activities of personnel. The key issue is for the HR directors to ensure that all roles within the matrix are fulfilled.

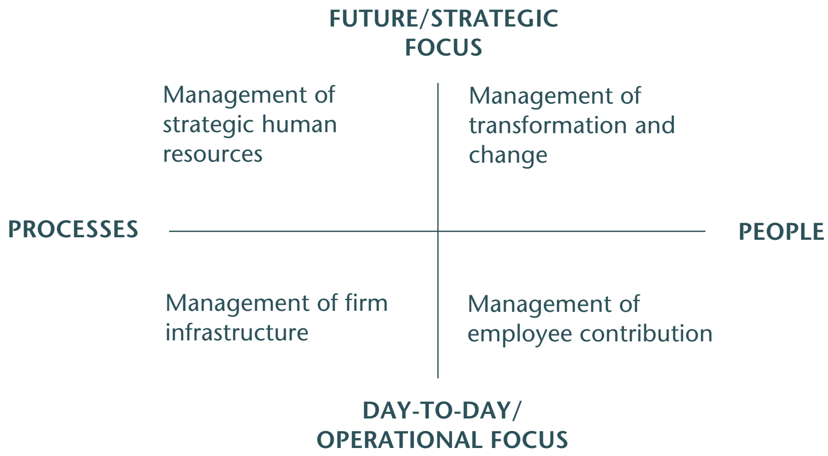

Figure 2 HR roles in building a competitive organisation (*Source: Human Resource Champions, Ulrich, 1997*).

Role/cell	Deliverable/outcome	Metaphor	Activity
Management of strategic human resources	Executing strategy	Strategic partner	Aligning HR and business strategy: 'Organisational diagnosis'
Management of firm infrastructure	Building an efficient infrastructure	Administrative expert	Re-engineering organisation processes: 'Shared services'
Management of employee contribution	Increasing employee commitment and capability	Employee champion	Listening and responding to employees: 'Providing resources to employees'
Management of transformation and change	Creating a renewed organisation	Change agent	Managing transformation and change: 'Ensuring capacity for change'

Figure 3 Definition of HR roles (*Source: Human Resource Champions, Ulrich, 1997*).

Releasing HR potential

For any organisation that wishes to develop its potential in the area of HR, it is crucial to understand its starting point. If the current capability within the firm is more akin to 'paternalism', then the senior management team will need to think carefully and invest heavily in developing a competence within three stakeholders: line managers, senior managers and the skills base of the HR function itself. It is, after all, fruitless trying to pole-vault before learning to walk. However, most enlightened Western organisations, both small and large, are taking steps to develop their abilities in the areas of people management and HR. In part, they are aware that the emerging economies are fast learning the lessons of the developed economies and striving to hone a sophisticated approach to this source of competitive advantage. The time of the HR expert has come!

Further reading

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MARKETING

PART 2 STRATEGIC MARKETING PLANNING

Malcolm McDonald, Cranfield School of Management

Marketing planning is defined, and the steps in the planning process are clearly set out, including a section covering the obstacles to implementing a marketing plan. Marketing audit, and organisation and control are also covered.

What marketing planning is

Marketing planning is simply a logical sequence and a series of activities leading to the setting of marketing objectives and the formulation of plans for achieving them. It is a management process which, conceptually, is very simple. Marketing planning by means of a planning system is, per se, little more than a way of identifying a range of options, of making them explicit, of formulating marketing activities which are consistent with the organisation's overall objectives and of scheduling and costing out the specific activities most likely to bring about the achievement of the objectives. It is the systemisation of this process that lies at the heart of the theory of marketing planning.

Marketing planning then is a managerial process, the output of which is a marketing plan. There are two outputs from the process of marketing planning:

- The strategic marketing plan, which covers a period of between three and five years.
- The tactical marketing plan, which is the scheduling and costing out of the specific activities necessary to achieve the first year's objectives in the strategic marketing plan.

The process and the output are shown in *Figure 1*.

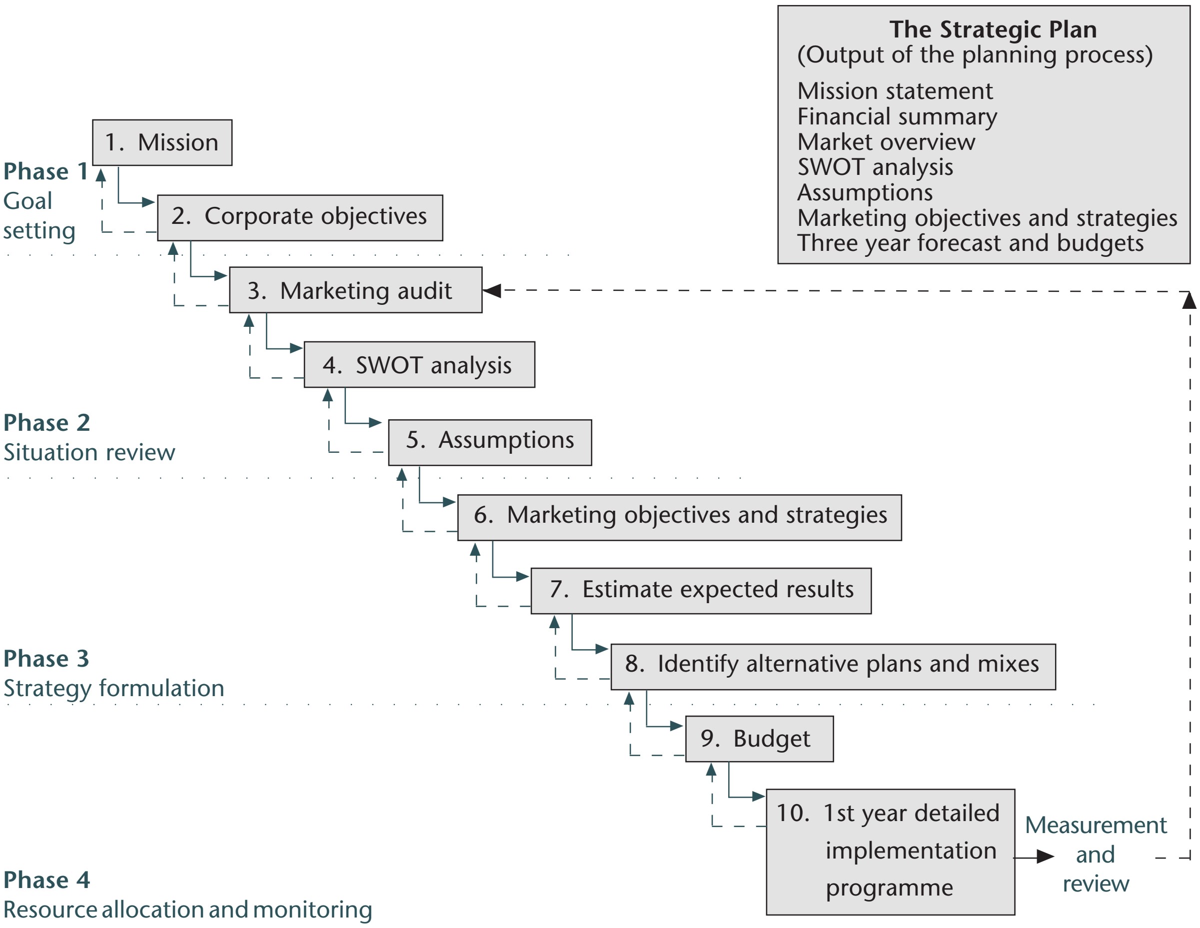

Figure 1 The ten steps of the strategic marketing planning process

As can be seen, the process starts with the organisation's mission and financial objectives, moves on to the marketing audit stage, which includes summaries in the form of SWOT analyses (strengths, weaknesses, opportunities and threats for main product/markets), then to the making of assumptions and the setting of draft marketing objectives and strategies for a three to five year period. At this stage, other functional managers get involved, to ensure that the organisation is capable of resourcing the market's requirements. Alternative plans are considered, one is chosen and budgets are then finalised, and eventually, tactical marketing plans are prepared. Headquarters will often consolidate both the strategic plans and the tactical plans into business or corporate plans. At the start of the organisation's fiscal year the tactical marketing plan is implemented and monitored via the management information system, until the whole process begins again. This process is redrawn as a circle in *Figure 2*, which obviates the question about whether the process is top down or bottom up, for clearly it is a continuous process.

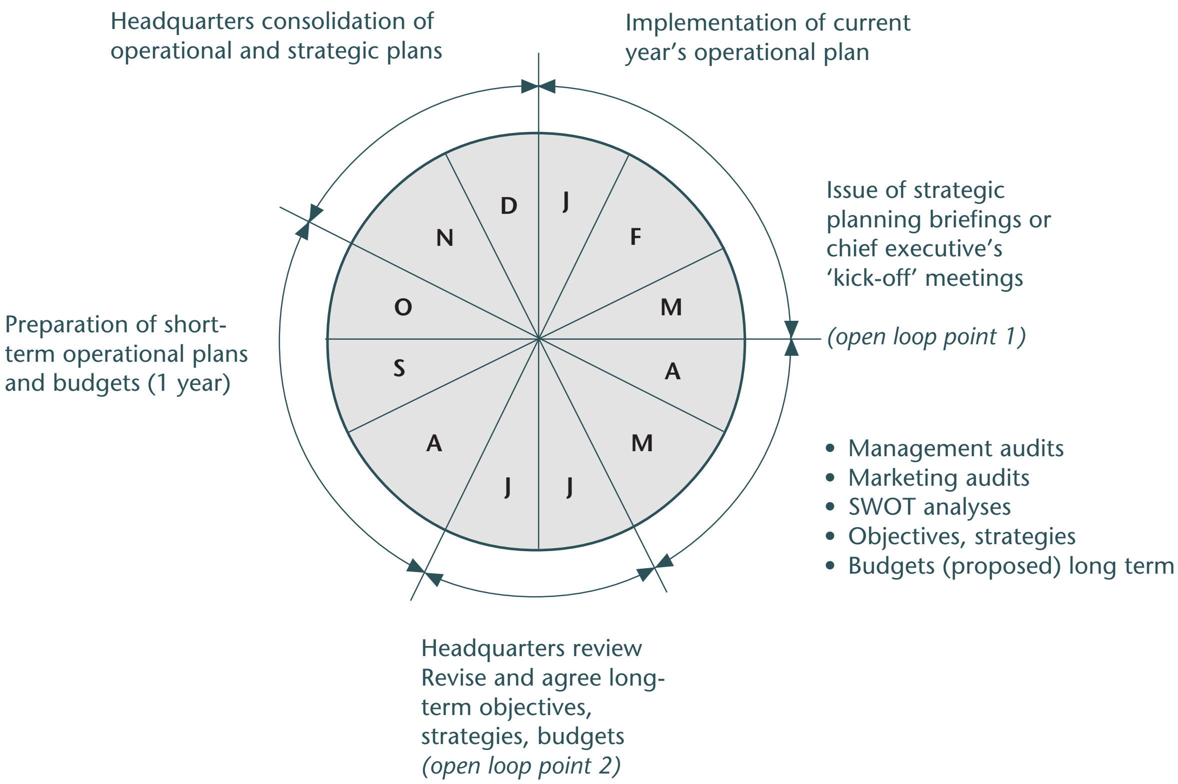

Figure 2 Strategic and operational planning

Why marketing planning is essential

The contribution of marketing planning to business success lies in its commitment to detailed analysis of future opportunities to meet customer needs and a wholly professional approach to making available to well-defined market segments those products or services that deliver the sought-after benefits.

But such a commitment must not be mistaken for budgets and forecasts, for these we have always had. The process of marketing planning is concerned with identifying what and to whom sales are going to be made in the longer term to give revenue budgets any chance of succeeding. There is no such thing as a 'market' – only people with needs and money. Any organisation must offer something to those people that will make them want to buy from them rather than from anyone else who just happens to be around. Today, because markets are generally oversupplied and customers have a wide choice, in order to persuade people to part with their money, their needs must be understood in depth and specific 'offers' developed that have a differential advantage over the offers of the competition. These offers are not physical products or services, but the totality of the relationship between supplier and customer and include its reputation, brand name, accessibility, service levels and the like.

In the simple environments of the 1960s and 1970s, characterised by high growth and the easy marketability of products and services, 'production' orientation was possible, largely because demand seemed limitless. During the late 1980s, when demand wasn't as buoyant as it had been, financial husbandry began its ascendancy. Indeed, it seemed to work for a while as profits continued to rise as costs were cut and productivity increased. Alas, the ratio-driven, cost cutting, margin management mentality persisted. Every product had to make a prescribed margin over the costs of producing it, otherwise prices were raised or it was taken off the market. Too little attention was paid to the number of times products were turned over, so low margin products were sacrificed, but of course with overheads either remaining or being closed down as organisations drove themselves upwards towards fewer, more profitable products. Eventually, *Anorexia industrialosa* set in (an excessive desire to be leaner and fitter, leading to emaciation and eventually death, a term coined by Andrew Lorenz of the *Financial Times*).

Companies went bankrupt at an unprecedented rate and TQM, balanced scorecards, BPR, relationship management, nor any other fad was able to stop the rot. Indeed, during a fifteen-year period, most of Britain's highest ROI PLCs disappeared, downsized or got into serious difficulties. Nor was the rot confined to Britain. According to Richard Pascale (*Managing on the Edge*), of Tom Peters' 43 excellent companies in *In Search of Excellence,* only six would have been considered excellent only eight years later. Sooner or later boards have to lift their heads above the parapet and look at their markets and their customers, instead of tinkering around with their own internal workings. World class companies such as Marks and Spencer have a passionate belief, driven from the board downwards, that it is only through creating superior value for clearly defined groups of customers that wealth is created for all stakeholders. Then, and only then, do the superb initiatives, referred to above, work – otherwise, they remain fads.

It is at this point that strategic marketing planning comes in and makes a major contribution to growth and profits. There is now a substantial body of evidence to show that requisite marketing planning results in greater profitability and stability over time and also helps to reduce friction and operational difficulties within organisations.

Barriers to marketing planning

Over 20 scholarly research studies into barriers to marketing planning have identified corporate culture and financially driven systems and procedures as the main barriers to effective marketing planning. It is clear that, until organisations learn to grasp the nettle of customer orientation, financial husbandry will continue to dominate corporate life, even though it has caused many companies to become casualties during the 1980s and 1990s and will cause more to become casualties as we approach the millennium.

This attitude is made worse by what companies actually measure when they define profit. A little thought will confirm that it is *customers,* not products or services, that make profit, as most costs are incurred after the product leaves the factory. For example, if one which buys £1m of goods insists on daily, just-in-time, store-by-store delivery, daily calls from the sales force and takes 120 days to pay its accounts, whilst another customer with a similar turnover wants one central warehouse drop, no sales calls and pays within 30 days, no-one needs to be a genius to work out which is the most profitable account. Yet a recent survey at Cranfield has revealed that about 85% of Western European companies still fail to allocate attributable interface costs properly and hence have little idea which are their profitable and unprofitable customers.

Another endemic problem is the depth of ignorance about what marketing actually is. This can be illustrated by the comment of one managing director at a public seminar, who aggressively announced, 'There's no time for marketing in my company until sales improve!' The truth, of course, is that marketing is an attitude of mind that manifests itself in the management process whereby the whole organisation strives to provide the required value to customers as a route to creating shareholder value. This is impossible to achieve in those companies that persist in organising themselves around tribes of personnel, accountants, engineers, IT, sales and so on. Such tribes will never subjugate their own tribal goals to the broader aims of customer satisfaction. Also, how can any organisation achieve customer focus whilst it continues to organise itself around what it makes, rather than around its customers or its markets.

The bottom line

British corporate cultures have traditionally been hostile to the marketing ethic. Directors who got their jobs as a result of behaviours which were appropriate in the 1960s, 1970s and 1980s, do not know how to respond to increased competition and static or declining markets. The gut reaction is to resort to their old behaviour, one of which, alas, is to cut costs without addressing the fundamental issue of growth. Growth, however, requires customers who want to buy things from us rather than from our competitors. Anyone can cut costs, but it takes real intellect to take a strategic rather than a tactical approach. Unsuccessful organisations don't bother with strategic marketing planning at all. Instead, they rely on sales forecasts and the associated budgets. The problem with this is that many sales people sell the products they find easiest to sell (usually at a massive discount) to those customers who treat them the best. Accordingly, by developing short-term budgets first and then extrapolating them, companies only succeed in extrapolating their own shortcomings.

Preoccupation with short-term forecasts and budgets is typical of those companies that confuse this approach with strategic marketing planning. Such companies are being left behind by companies with directors with vision, who themselves lead the effort to understand their markets and their customers and who are bright enough to know that it is only by creating superior customer value that they will survive and thrive beyond the millennium. This is where strategic marketing planning comes in, with a number of plans, or models, being created, which spell out quantitatively and qualitatively the value that employees have to create. In summary, a strategic marketing plan should contain the following.

- A mission or purpose statement.
- A financial summary.
- A market overview.
  - what the market is;
  - how it works;
  - what the key segments are.
- A SWOT on each segment.
  - what value does each require?
  - what value can we create to persuade customers to buy from us?
- A portfolio summary of the SWOT.
  - this classifies segments according to our relative strengths, and the potential of each for growth in profits over the next three years.
- Assumptions.
- Marketing Objectives and Strategies.
  - prioritised in accordance with the portfolio summary.
- Budget – for three years.

Further reading

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FINANCE PART 2 OPERATING AND BUSINESS SYSTEMS

Judith Shackleton, Faculty of Finance and Management, ICAEW

Good systems are vital for a successful organisation. We discuss reporting structures, the content of management accounts, performance measures, business risk, and how financial control can best be maintained.

Introduction

In this issue, we cover the maintenance of good operating and business systems. Without proper systems, the management of the business can easily run out of control. Good control provides a stable framework within which to operate. This control framework need not be restrictive but must measure performance and act as an early warning system. The type of operating and business systems used depends upon the nature of the organisation. A simple paper-based system may be the most appropriate for a small sole trader, although most operating and business systems will benefit from some type of computerisation. The choice of package depends on the size, type and complexity of the business. The system should be designed so that it can grow and change with the changing direction of the business. Re-specifying a system can be a costly and time-consuming process. As far as possible, different systems should be interfaced effectively so that data does not have to be re-entered and recaptured.

Structures should be in place to generate and gather good information. This information then needs to be used to help improve the performance of the business.

The remainder of this article has been structured to reflect the different requirements of individual companies and of groups.

Performance measurement and business analysis

Company

Performance measurement should focus on both financial and non-financial criteria. The information to be measured should focus on measures of the value or success of the company and the factors that generate value – the value drivers. These will obviously vary from company to company and cannot be established without a full understanding of the business.

Case study – sales growth

A large FMCG company prided itself on increasing sales growth year after year. Sales targets were a key measure of success. However, when the company commissioned an advertising effectiveness survey they realised that for some products it was actually costing them more to achieve these extra sales than they were achieving in additional revenues, so by selling more of these products they were actually losing money. As a result, they analysed their portfolio of products and decided to focus on only growing those brands where the marginal cost of achieving those extra sales was lower than the marginal income from those sales. They changed their performance measurement system to focus on the marginal revenue from sales, rather than looking at the growth rates alone.

Key financial measures include the value of the order book, sales, profit, cash flow and borrowing levels. Non-financial criteria are just as important. Examples of non-financial criteria include customer satisfaction ratings, service levels, quality, order enquiries. These can be seen as ‘leading indicators’, as changes in them reflect the business reality that will ultimately be seen in the financial results.

One technique which combines financial and non-financial business indicators is the balanced scorecard. Companies implementing the scorecard appreciate that performance measures that only relate to financial measures can generally be achieved, but often at the expense of customer relations or other factors that will affect the future of the business. The scorecard is a means of identifying measures along (generally) four dimensions:

- **Financial** To succeed financially, how should we appear to our shareholders?
- **Customer** To achieve our vision, how should we appear to our customers?
- **Operations** To satisfy our shareholders and customers, at which business processes must we excel?
- **Internal learning** To achieve our vision, how will we sustain our ability to change and improve?

The above list may differ from company to company depending on the critical success factors needed to deliver a strategy.

Implementing the scorecard involves a full and detailed understanding of the company's strategy and how this can be achieved. Performance measures on the various dimensions can then be set for employees throughout the organisation. It is important to tie employee incentive schemes into these performance measures so that everyone works towards the same goal.

Groups

Performance measurement will be more formal within a group. The measures used for a group will tend to be more financially based as they are easier to aggregate. However, at a group level, non-financial measures should still be used, particularly for new business developments.

In many companies, but particularly in larger groups, the majority of the financial analysts' time is spent extracting and checking data, leaving very little time to actually analyse it. Clearly, the business systems need to be able to provide information quickly and accurately to avoid this problem.

It must be possible to look at each business on a stand-alone basis as well as being part of the group. The question should always be 'would this business generate more value as part of the group or on its own?'.

It can be tempting to ignore or forgive poor results, particularly in smaller operating companies. There may be historical reasons why management does not wish to interfere. But often the group's shareholders may gain more value by selling the business than by retaining it, especially as small subsidiaries often take as much effort to manage as larger parts of the group.

Internal reporting structures and systems

Company

The structure put in place needs to be sufficient to generate all the information required for the performance measurement and business analysis. One person should control the process, usually the finance director of the company. If possible, the whole process should be integrated to eliminate data needing to be re-keyed. In addition to being inefficient, the re-capture of data can introduce errors.

The timeliness of the information depends upon the nature of the business. How often does the data need to be reviewed? For a high volume retail business on-line sales figures let managers monitor the hourly performance of sales. Most retailers have systems in store so that the day's sales figures are collected and ready for analysis the next morning. For other businesses, weekly information is sufficient and for companies dealing in larger contracts a monthly report may be enough. A balance must be struck between the cost and time taken to collect information quickly and its value.

There must be some forum for review, usually a daily, weekly or monthly management meeting.

Group

The data for the whole group need to be collected promptly, summarised in a user-friendly way, assessed and circulated. In general, sub-consolidations should be avoided as they cause delay and introduce a lack of transparency.

Maintaining financial control

Company

The financial controller or finance director must have access to all necessary information to form a balanced view of the business performance. In particular, key ratios or balances should be monitored for any early signs of trouble. There should obviously be tight control of accounting and financial reporting. A key control is to measure outcomes against expectations, which means that the planning and budgeting processes must produce high quality output. Good financial control ensures that any potential problems are identified early on and there are no surprises.

Group

In addition to the above, there should be a system of formal and informal reporting and contact throughout the finance network. The group finance personnel should visit and meet with finance team based at subsidiaries. Regular group forecasts, including all the critical financial measures should be compiled to ensure that group is up to date on any issues.

Good management accounts

A good set of management accounts should be produced quickly and be easy to understand. Always think of the recipients – who they are and what they need. In general, the rest of the management team will not be other accountants and do not need pages and pages of numbers. Figures are obviously important but they should always be summarised, analysed and explained.

Do not produce a strings of meaningless or empty statements such as ‘sales have gone down this month’. Explain why sales have dropped (because customers have bought less is *not* a sufficient explanation), what the impact is on the full year results, and the actions needed to get back on target.

Management accounts cannot be produced in isolation; the production process should build in time to discuss key numbers with the relevant managers and incorporate their comments.

Cash flow reporting is very important, particularly good cash flow forecasting. (*Good Practice Guideline* 7 discusses this subject.)

Good management accounts should:

- Identify key measures (financial and non-financial).
- Explain anything unusual.
- Look forward not backward.
- Identify actions to be taken.
- Report on progress of actions taken.
- Use graphs to display trends.
- Include forecasts of expected results.
- Strike an appropriate balance between speed and accuracy.
- Collect data efficiently.
- Not cloud key messages in unnecessary detail.

The management information should be relevant, and easy to produce. Questions to ask are:

- Who needs this information?
- How accurate does it have to be?
- When is it needed?
- How cost-effective is it to obtain? (If the answer is 'not very', reconsider the above points, or change systems.)

Management of operating risk

Company

Management of business risk should be part of the business planning process. Risks should be identified and regularly updated. A regular risk report should identify the following for each of the key risks:

- Description of the risk.
- Impact of the risk on the business.
- Likelihood of the risk happening.
- Manager responsible for managing the risk.
- Existing controls in place.
- Any further actions needed to reduce the risk.
- Timescale for future actions.

Group

The attitude to risk management within a group depends to a large extent on the management culture and type of business. For a group with autonomous subsidiaries the responsibility for risk management may be fully delegated with reports on overall exposure and large items given to group. In other groups strict limits on risk-taking may be set in order to control the overall group exposure level. Many companies incorporate a risk review as part of the strategic planning process.

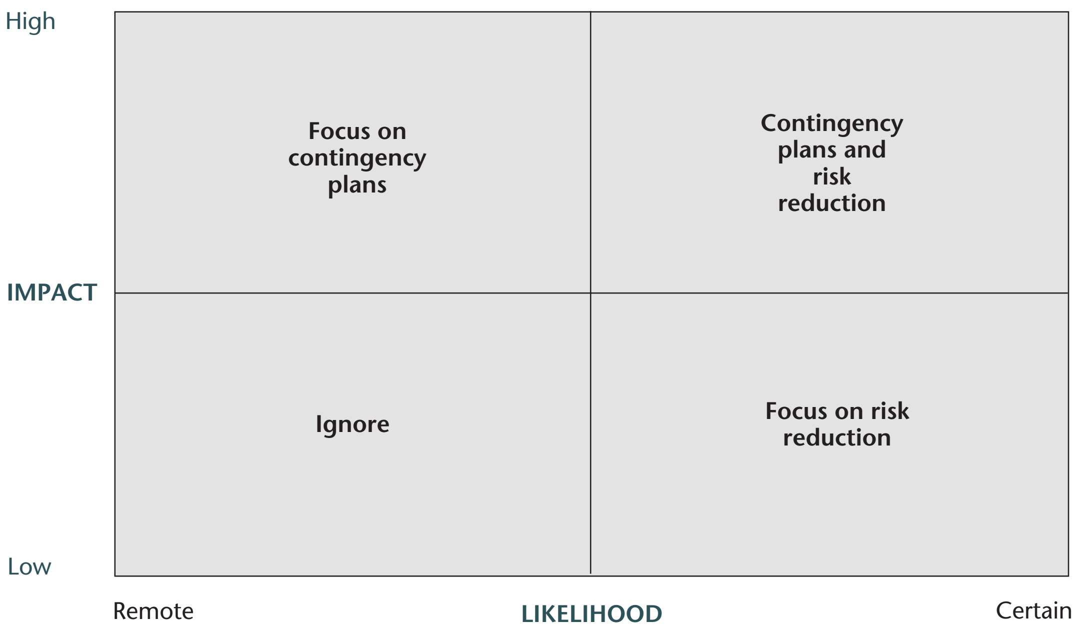

Figure 1 Impact of risk vs likelihood

Further reading

- **'The Balanced Scorecard - Measures that Drive Performance'**

  Kaplan RS and Norton DP *Harvard Business Review*, Jan/Feb 1992

- **'Putting the Balanced Scorecard to Work'**

  Kaplan RS and Norton DP. *Harvard Business Review* Sep/Oct 1993

- ***The Balanced Scorecard***

  Kaplan RS and Norton DP Harvard Business School Press, 1996

  Kaplan and Norton invented the balanced scorecard. The two Harvard Business Review articles set out clearly the basics of how it can operate. The book expands the articles with a lot of practical examples, and covers the strategic issues very well.

- **ICAS *Measurement – The Total Picture***

  1993

  This discussion document looks in depth at performance measures and how they link to a company's strategy and business plan. Detailed appendices suggest non-financial measures for every aspect of an organisation. The document was reviewed in the Faculty's Reading Focus 8, *October 1993.*

- ***Technical Focus 10* Business Risk Management**
- ***Good Practice Guideline 5* Management Information**
- ***Good Practice Guideline 7* Working Capital**

KNOWLEDGE MANAGEMENT

Ron Young, Knowledge Associates Ltd

This article is included in this issue as part of an occasional series of interesting topics which it is hoped will prove useful to readers. The author gives his definition of knowledge management. It is a new area, full of opportunities: as with all new areas, there are several different approaches.

What is knowledge management?

Why all the fuss? After all, we have been managing our knowledge in our first universities since the 12th Century. Knowledge management, to me, is the result of a fusion that has recently taken place between new learning processes and people management on the one hand, and, on the other, new communication and group collaboration technologies (to connect people together globally, through groupware, the Internet and the World Wide Web). As a result, some radical and fundamentally new processes have been developed. We can now manage our knowledge in ways that were simply not possible, or even dreamed about, just a few years ago. The real opportunities before us now are:

- How can we create new knowledge faster and better than ever before?
- How can we retain new knowledge in our organisations more effectively?
- How can we share our knowledge throughout the organisation better and faster?

Knowledge sharing sounds simple enough, but I suggest that it is one of the key issues in knowledge management – and, indeed, one of the critical success factors. 'How can we account for knowledge?' may sound contradictory, because it raises the issue of measuring and accounting for such an intangible as knowledge, but it can be done, and there are new systems and tools that have been developed that enable us to manage, measure and compare knowledge capital. Shortly, in London, the first preliminary report by the International Accounting Standards Committee, on intellectual capital metrics, will be made public. Accordingly, the days of auditing knowledge capital for public companies are upon us.

Knowledge management is also about leveraging knowledge. Before even considering new ways to create new knowledge better and faster, we should consider the fact that there is so much knowledge in the organisation today that is not utilised to the full. Knowledge leveraging is about capitalising on existing knowledge now. If we can find better ways to leverage out that 'tacit' potential knowledge faster, into new products and services for our customers, then the benefits become clear. In addition to this, and most significantly, there have been some startling new technologies that have enabled us to consider all the above issues in an entirely new perspective, and provide some radical and fundamentally new ways to create, develop, retain, disseminate and measure knowledge across organisations. The integration of Lotus Notes groupware with the Internet, Intranets and the World Wide Web, is probably one of the most startling examples of new integrated technologies which give us totally new work perspectives and capabilities. That is what is at the heart of knowledge management is. When all of these elements are combined properly, a new organisational model appears: it is known as the *knowledge organisation.*

Knowledge accounting categories

We now tend to categorise knowledge, for better measurement, management and understanding, into three key inter-connected areas. These areas are called 'human capital', 'structural capital', and 'customer capital'. By *human* capital, we mean the collective knowledge that is contained within the individuals in the organisation. This is the knowledge that walks in and out of the organisation every day. Step 1 is to measure this human capital by measuring human competencies through a competence development and management system. Step 2 is to convert this human capital (tacit knowledge) into *structural* capital (explicit knowledge). This is the kind of knowledge that has been structured in a variety of ways and embedded in our business processes, particularly smart business processes; in products and services; in copyrights, patents, procedure manuals, best practices and so on.

The third area, *customer* capital (sometimes called market capital), is the result of leveraging our human capital and our structural capital, to create a capital that consists of valuable customer relationships, ultimately resulting in customer loyalty. Customer capital manifests itself, ultimately, in long-term trusting partnerships. Therefore, knowledge management has a significant and highly strategic role in creating customer loyalty and long term trusting partnerships.

The business rationale for knowledge management

So what is the business rationale for knowledge management? How can better knowledge management fit in to the overall business strategy? The starting point is that most organisations are seeking long-term sustainable growth and profitability, whatever line of business they are in. Whatever way we look at this, cutting through all the latest buzzwords, a key, if not the key, to achieving long-term loyalty with all the stakeholders in the business is to delight them continually. This means more than merely satisfying them; that is simply not good enough any more. In today's marketplace, we must exceed expectations and continually delight. We have raised the pole significantly. Tom Peters refers to this as 'blowing their socks off'. How can we possibly continually delight? By comparison with our competitors, we have got to deliver some extraordinary products and services which, in turn, are produced by some extraordinary underlying business processes. This means extraordinary processes to create, to distribute, to sell, to service and support, etc. But the key business process of all, which it is suggested will contribute more to developing extraordinary products and services, is the development of extraordinary people – the people development process. This is because extraordinary new process designs are simply useless unless there are some extraordinary (or world class) teams of people who are able to perform them.. If we can do this, by rapidly converting more of the tacit knowledge into new products and services (ie, turn human capital into structural capital faster), then the customer capital will start to accumulate. And the loyalty and trust – and profitability -– will follow.

The next challenge is to change the management style to support and develop this new way of knowledge working. Managers really should have only one true primary role – to coach and develop the competencies of their teams, and strive for world class quality, and to facilitate the organisational processes – to bring about customer delight and long-term loyalty. Unfortunately, many managers today are managers because they are loyal and good at performing tasks, despite the fact that they may be very bad coaches of people and very bad facilitators of business processes and the organisational objectives. They urgently require these new skills – and they can certainly be learned by most managers.

Knowledge competencies

The most interesting development that I have observed, as we are making the transition from an information-based society to a knowledge-based society, is the special need for people who are competent in managing knowledge. We desperately need people who know how to create, develop, retain, disseminate and measure knowledge, who are well skilled and experienced in knowledge management, and who have the right attitude to knowledge management (which is predominantly an attitude of sharing, rather than protecting, knowledge). I call these new special competencies of the knowledge worker the 'knowledge competencies'. As we move into the 21st Century, knowledge competencies are the strategic competencies for knowledge workers within the knowledge organisations. In the USA today, over 60% of the workforce are employed to manage information as information workers. I believe that the key emerging workforce is now that of the knowledge workers. So what is the difference between information and knowledge?

The knowledge spectrum

There is much to learn about the transition from data to information to knowledge to wisdom, but the knowledge spectrum is certainly a useful model to better understand the different characteristics.

'Data' can be simply described as unorganised, disorganised words, letters, pictures, etc with no particular context or meaning, or perhaps a meaningless string of material with a start and an end.

'Information', on the other hand, is data that has been organised, by somebody else, into a specific context. However, as information is, in this context, that which has been organised by another person, it may be relevant, meaningful and useful to any given recipient, or meaningless, irrelevant and useless, to take both extremes. Information is structured data.

Knowledge is the next step, and the difference is that personal knowledge is organised by ourselves. It is the result of new learning, which comes about through filtering out the meaningful and useful information, analysing it, putting it into our own special meaning and context, and synthesising it into our larger personal 'knowledge bases'. This may be a knowledge base within our heads and/or a knowledge base that has created in some other form. However, knowledge, unlike data and information, is structured in a more complex web of associations. The brain creates lots of different interconnections and associations of new learnings and experiences in memory. This web like structure is multi-dimensional, unlike data and information.

Wisdom is the result of a slow osmosis, over a period of time. As specialised and quite different areas of knowledge develop in depth and breadth, so some fundamental principles, truths, perspectives and realities emerge. It is when we cross-fertilise these principles, truths, perspectives and realities, between different specialised areas of knowledge, that we develop some completely new super-useful knowledge, insights and more generalised and universal truths and realities. This is wisdom.

So the knowledge spectrum, as it may be called, is one of increasing meaning, complexity, interconnectivity and dimensions. And the process of developing personal knowledge is one of acquiring new information, filtering, analysing, synthesising and sharing.

Practical next steps

To finalise, how can we turn the theory into practical next steps with our knowledge management initiatives?

Experience suggests the following nine point action plan:

1. Formulate some clear knowledge management objectives – that link knowledge to business objectives.
2. Develop a knowledge management infrastructure.
3. Design the new knowledge management processes.
4. Map the strategic core competencies to perform the knowledge management processes.
5. Clarify the new roles, responsibilities and rewards – to support knowledge sharing.
6. Anticipate the cultural barriers.
7. Develop managers into 'knowledge managers' as coaches and facilitators.

8. Identify and deploy the appropriate technologies.
9. Pilot and measure the impact.

If our challenge is continually to delight our customers and clients and gain their long-term loyalty, we need to create extraordinary products and services, based on extraordinary business processes that are performed by extraordinary people. Knowledge management is the extraordinary discipline that will do this.

That is the difference between managing with information and leading with knowledge.

OUTLINE SYLLABUS

Management Quarterly is designed to be an three-year endeavour, setting out key management techniques in core disciplines. Over that time, it is expected that the content may develop and change. However, here we set out the current anticipated syllabus for the journal.

Strategy

What is strategy? ✔ *Part 1, October 1998*
What does corporate HQ do? ✔ *Part 2, January 1999*
Corporate strategy and M&A
Competitive strategy
Strategic analysis tools – the external environment
Strategic analysis – assessing internal resources
Linking external and internal analysis
Strategic choice: stakeholders
Strategic decision making
Strategic change
International strategy
The future of strategy

Human resources

Introduction to people management ✔ *Part 1, October 1998*
Changing roles and responsibilities ✔ *Part 2, January 1999*
Strategic HRM and the management of change
Resourcing the organisation
Motivating and monitoring
Developing the organisation
Personal development and people management competencies
Managing conflict and difference
The role of trade unions and collective representation
Impact of the European Union
International HRM
Ethics and corporate governance

OUTLINE SYLLABUS – *Continued*

Marketing

Marketing in today's world ✔ *Part 1, October 1998*
Marketing planning ✔ *Part 2, January 1999*
Understanding customers – the consumer
Understanding customers – the organisation
Market research and information technology
Market segmentation and positioning
Analytical tools for marketing
Managing the marketing mix
Developments in marketing
Relationship marketing
Branding
International marketing

Finance

Planning and reporting ✔ *Part 1, October 1998*
Operating and business systems ✔ *Part 2, January 1999*
Interest and discounted cash flow
The cost of equity
The cost of capital
Shareholder value
Valuation of companies
Financial instruments
International finance
Mergers and acquisitions
Project finance
Venture capital

Articles are also being commissioned to cover: project finance, information systems, just-in-time operations, total quality management. Further material on people management, concentrating on the individual rather than the organisation, will also be included.

IN THE NEXT ISSUE . . .

Strategy *Corporate strategy and M&A*

The characteristics of mergers, acquisitions and strategic alliances, and how they can help meet strategic objectives.

Human Resources *Strategic HRM and the management of change*

Discusses ways in which the HRM function can contribute to successful organisational change in the longer term.

Marketing *Understanding customers – the consumer*

A discussion of customer and consumer behaviour and decision making.

Finance *Interest and discounted cash flow*

A review of the components of interest rates, and a refresher of discounted cash flow principles as a lead-in to later parts of the syllabus.

Management Quarterly will act as an aide-memoire for members, provide new ideas, and encourage good practice, but the Faculty cannot accept responsibility for the accuracy or completeness of issues of *Management Quarterly*. **Being general in nature, the points made in *Management Quarterly* may or may not be relevant to specific circumstances.** Responses from the membership will be a very important part of the successful development of the series. Comments please, to Chris Jackson on 0171-920 8486 (or by e-mail to CDJackson@icaew.co.uk).

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Any members who have not received the above should contact Chris Jackson at the Faculty using the contact details set out below.

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