Manager Update

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A quarterly summary of topical management ideas, focusing on four key issues

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND & WALES

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Manager Update

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Manager Update helps the general manager keep abreast of the latest articles in specialist management journals. The most useful ideas in the fields of strategy and organisation, marketing, accounting and finance, and human resources management are carefully selected from a wide range of publications with the busy general manager in mind.

Experts in each field explain and discuss the relevance, practicality and usefulness of the key new concepts and ideas, thus enabling the senior executive to keep really up-to-date.

The articles represent the personal views of the authors and not necessarily those of their organisations or of the Faculty. The nature of some subjects will preclude the articles from being definitive or mandatory. Being general in nature, the points made in **Manager Update** may or may not be relevant to specific circumstances.

The Faculty committee intends that **Manager Update** will act as an aide-memoire for members, provide new ideas, and encourage good practice, but cannot accept responsibility for their accuracy or completeness. Responses from the membership will be a very important part of the successful development of the series.

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Susan Foreman is Marketing Faculty Group Leader, Henley Management College.

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Richard McBain is Director of Distance Learning Programmes, Henley Management College.

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Ian Turner is Professor of Management Studies and Director of Graduate Business Studies, Henley Management College.

The revolution in risk management

Recognition of the increased importance of risk management seems to be prompting significant changes in both thinking and practice within companies. Consideration of risk needs to apply to the company as a whole. It is critical to identify what drives the different types of risk and how these affect shareholder value. Risk has thus become a major strategic issue. Moreover, the plethora of new products available seems to reflect a growing convergence between capital and insurance markets. **Roger Mills** argues that this may also cause internal roles, such as those of risk manager, treasurer and chief financial officer, to converge.

There is a view that finance and risk have a stronger linkage than has been immediately obvious in the literature of the respective disciplines. A noteworthy review of this linkage has been provided in the *Journal of Applied Corporate Finance*, Winter 2002, where a number of articles providing useful insights are to be found. Some of these articles are reviewed in this Update.

First, Lisa Meulbroek, Professor of Business Administration at the Harvard Business School provides ‘A senior manager’s guide to integrated risk management’. In this article, she makes a case for what she refers to as ‘integrated risk management’ that involves the identification and assessment of the collective risks that affect company value and the implementation of a company-wide strategy to manage them[1]. Her guide provides good insights for understanding the issues and for identifying the challenges to be addressed.

Muelbrook’s guide can be thought of as being an enterprise-focused perspective, which is usefully reviewed alongside other views that have been expressed on the links between finance and risk. For example, Dr Christopher Culp offers insights that challenge traditional boundaries between capital and insurance markets[2]. Culp is not alone in challenging these boundaries and we will also review the work of P Schimpi who portrays a view of prospective finance based upon the traditional financial conventions and what he refers to as the ‘insurative model’[3].

Last, but not least, with reference to an article by Ian Chapman and Tim Astley, we consider the all-important issue of what is the appropriate level of risk for an organisation[4].

Finance and risk have a strong linkage

A senior manager’s guide to integrated risk management

Meulbroek sees companies having three fundamental ways of implementing risk management objectives:

- modifying operations;
- adjusting capital structure; and
- employing targeted financial instruments.

According to Muelbrook, integration requires these three to be combined, with the goal being to maximize value by shaping the company’s risk profile, necessarily involving the removal of some risks and the retention of others. The emphasis is strategic rather than tactical and the distinction is made with reference to an example involving the hedging of contracts for the purchase of goods or services from a foreign country at some future date. As such, the focus in this instance is specific to the transaction, whereas a more strategic approach would be directed at questioning how exchange rate fluctuations would affect the value of the entire company.

Integrated risk managament – ie evalutaing a company’s total risk – can be used to maximise value

It is important to recognise that integration means both the integration of risks and integration of ways to manage risks. Integrated risk management evaluates the company's total risk exposure instead of evaluating each risk in isolation, and this is important because it is the total risk of the company that typically matters to the assessment of the company's value and its ability to fulfil its contractual obligations in the future.

Understanding a company's risk drivers is essential in creating an optimal risk policy

There is an interesting challenge associated with having integrated risk management as an objective and it is one that has parallels with the developments associated with value based management (VBM). As anyone who has worked with VBM in practice will know, one of the major challenges is to have a conceptual framework for management to understand the key influences upon the value of the business, in terms of the key 'value drivers'.

These value drivers vary from business to business, and over time. What is important to a property company may well be very different than that for a financial services business. Equally, the relative importance of the drivers of value in the start up phase of an operation will be very different to those in maturity. Understanding these value drivers is very important in thinking about an optimal risk policy. It is vital that managers understand how the degree of uncertainty about these value drivers can potentially affect company value. In other words, to set risk targets, managers have to understand the channels through which risk can affect company value.

Given that the fundamental goal of risk management is to maximize shareholder value, the question arises how? There are some fairly well documented methods of risk management in the finance literature, a few of which are reviewed by Muelbrook. These include:

- *systematic risk management* – according to financial theory, total risk consists of systematic (market or beta) risk and specific (unsystematic) risk. In a world with widely available diversification opportunities, systematic risk is the only risk for which investors require compensation. Whilst systematic risk cannot be diversified away by investors or management, exposure to it can be mitigated by adjusting holdings of risky assets and cash, or by hedging with futures, forwards, or swap contracts. Although in principle such exposures could be managed by investors, it is argued that in practice they will not have sufficient understanding of the company's exposures, thereby making this a rich potential area for sound corporate level risk management; and
- *capital structure management* – optimal capital structure is a much publicised but poorly understood concept in finance. The principle that via careful management and structuring of debt and equity, an optimal capital cost can be found that avoids financial distress is well founded. However, in practice, estimating such an optimal position is a real challenge and not well covered in the literature. However, techniques are available for trying to understand this, not least of which is the use of cash flow stress testing against disaster based scenarios associated with the impact of problems relating to the core value drivers of the business.

Risk management is on a course of convergence with modern corporate finance

The revolution in corporate risk management

According to Culp, there has been a revolution in corporate risk management over the last decade. In his article on this revolution, Culp surveys the last decade of innovations in risk management, from risk management as a process to risk management products, emphasising the confluence of risk management and corporate finance. He begins with a discussion of where things stood before the series of financial scandals and disasters in the early 1990s. Specifically, he reviews different perspectives on risk management that, until the 1990s, seemed to have co-existed in to all intents and purposes independent spheres of theory and practice. He also discusses the forces of convergence that have worked together to unify these disparate risk management perspectives and practices in the last 10 years. Last, but not least, he describes some of the most important innovations, first in risk management as a process and then in risk management products.

Culp's underlying thesis is that risk management appears to be on an inevitable course of convergence with the modern theory of corporate finance. He argues that companies today can focus selectively on risk finance or risk transfer, use features like triggers to control the cost of capital acquired through risk management products, integrate their financing and risk management decisions through the use of enterprisewide products, and replace expensive paid-in capital with cheaper sources of contingent capital that provide an infusion of funds only when truly necessary. Such expanded products are likely to be beneficial, however, only if a company has the right risk management process in place, one in which corporate financial and risk management decisions are no longer made separately, but in a fully integrated way that is clearly informed by the goal of increasing company value. Therefore, key within the risk management revolution is what Culp refers to as 'convergence'. This convergence relates to various perspectives on risk management once divided by extreme differences in vocabulary, concepts, and methods; convergence of organisational processes for managing an extraordinary variety of risks; convergence of risk management products offered by hitherto completely separate industries like insurance and capital markets; and, finally, convergence of risk management with the quest for the corporate holy grail of optimal capital structure.

At the heart of this revolution is what Culp refers to as 'alternative risk transfer' (ART), which he defines as the large and growing collection of 'contracts, structures, and solutions' provided by insurance and/or reinsurance companies that enable companies to transfer or finance some of their risks in non-traditional ways[5]. ART represents the foray of the insurance industry into the corporate financing and capital formation processes that were once the near-exclusive domain of commercial and investment banks. Culp recognises that to discuss risk management in a corporate finance context is still considered odd by some, but he acknowledges that a handful of finance academics have suggested this for well over a decade when discussing optimal corporate financing and capital structure[6]. In fact, he argues that not taking account of risk management opportunities in a corporate finance context is quite likely to lead to serious inefficiencies in how a company manages risk or raises funds – if not both.

According to Culp, a comprehensive approach to corporate finance must begin with a risk management process and strategy that aims explicitly at maximising the value of the company. Then, in executing that strategy, management must consider the full range of available risk management products, including new risk finance products such as 'contingent capital' and 'finite risk' contracts along with well-established risk transfer instruments like interest rate and currency derivatives. Given that this range today encompasses both new and established products provided by insurance companies as well as commercial and investment banks, a comprehensive approach to corporate finance means taking account, and full advantage, of the convergence accomplished in the last decade.

Capital and insurance markets are converging and developing risk tools with features from both

The changing function of risk management

Schimpi has identified that the revolution in corporate risk management may have important implications for roles and responsibilities[7]. The risk manager and treasurer are typically entrusted with managing operational and financial risks within the framework of a given capital structure, but the composition of the risk is the responsibility of the CFO. Besides avoiding or reducing risk, the risk manager has traditionally had recourse to the insurance markets to transfer risk to third parties, and the treasurer has had recourse to the capital markets to transfer risk and (separately) to obtain financing. The CFO has often viewed the capital markets as the primary vehicle for maintaining or transforming capital structure.

This will have implications for the roles of the risk manager, treasurer and CFO

As capital and insurance markets converge, progressive organisations have started developing risk management tools that incorporate features of both. For example, a 'new' integrated risk management product outlined by Schimpi provides a single block of insurance capacity that protects against a broad set of risks, both those that are traditionally insured and those that are hedged in the capital markets. The rationale is that it may be inefficient to purchase insurance and financial loss protection separately, because the corporation may be overprotected on the financial side and under-protected on the insurance side, or vice versa. By purchasing an integrated cover that protects both insurance and financial exposures, the corporation is assured that capacity will be available no matter what the source of the loss is.

The consequence is that no matter what the source of the loss is, the ultimate effect on the bottom line is the same. Another consequence of the convergence of insurance and capital markets is the development of tools that combine risk transfer and financing. For example, finite risk reinsurance products combine financing and risk transfer in a way that allows corporations to achieve in a single transaction the benefits of both insurance and debt financing.

The revolution in risk management techniques outlined by Schimpi has implications for the CFO as well. Any policy regarding capital structure configuration is predicated on an assessment of the risks confronting the corporation. Schimpi illustrates this with what he calls the 'insurative model', where a company's risk profile may change as a result of the implementation of new risk management instruments, with a consequent change in the corporate capital needs.

Combined risk transfer and financing tools are emerging

He shows that instead of simply optimizing the balance of debt and equity, the CFO now has at least three instruments to use: debt, equity and insurance. In addition, there are techniques that directly address the capital structure issue. Given that equity capital is an expensive source of long-term financing, and that the risk profile of a company determines its required amount of equity capital, substitutes for paid-up equity capital have the potential to offer significant economies. Contingent capital products, for example, promise to infuse the company with capital precisely when it is needed in the event of a catastrophic loss. These products eliminate the need to hold expensive on-balance-sheet equity capital for those rare events that may inflict severe financial harm on a corporation. An off-balance-sheet contingent capital facility (almost insurance, but not quite) can be cost effective.

New worlds are opening up for the speciality insurance markets

According to Schimpi, the days of clearly defined boundaries between capital markets and insurance arenas are over. Newer, speciality insurance products are emerging to insure financial risks not traditionally covered by insurance. New worlds are opening up for the speciality insurance markets. Where traditional insurance is reluctant to go, speciality insurance now stands, firmly securing a foothold in the financial risk arena. He sees taking on balance sheet, capital securitisation, credit-worthiness and even shareholder value speciality insurance as the prospective darlings of financial institutions that are looking for more assurance on their loans. He also sees it as a vehicle that other companies are using to free up capital that is otherwise reserved for potential losses. It is also having a positive effect on the balance sheet, as well as giving customers more options to protect their businesses.

Schimpi argues that traditional methods like loss portfolio transfers, transferring future claims payment obligation, and credit insurance which have been around for some time, will be supplemented with new insurance programs to cover financial risk. Furthermore, he illustrates that some corporations are looking for ways to use insurance to free up capital that sits dormant on the balance sheet as reserve capital. According to Schimpi, companies using these solutions could be very broad, ie they could 'range from banks to energy companies, from tire manufacturers to grain growers'. The reasons are as varied as the companies themselves, and range from reducing balance sheet risk to giving collateral value to transactions, as well as integrating hazard risk into one financial cover.

For a financial institution, it is easy to see how these types of insurance products make sense. One example quoted by Schimpi is the Royal Bank of Canada (RBC) that signed a deal with Swiss Re to guarantee the bank up to $200 million (Canadian) should the bank's loan portfolio experience exceptional losses. The deal allows RBC access to otherwise reserved capital without the risk of a loss crippling the bank and for Swiss Re, it is an investment, as well. The heart of the argument about this deal is that it is far more efficient for Swiss Re to take in the premium, reinvest it, and be standing by ready to cover the risk should (a significant loss) happen.

Schimpi also cites that companies other than financial institutions are experiencing the benefits of insurance as financial cover. For example, one of the first deals involving the application of insurance to financial covers was the United Grain Growers of Canada (UGG) deal in 1990. The deal, which was worth $250 million (Canadian), integrated the hazard risk that UGG faced with the risk to the balance sheet from a fluctuation in grain volume. Swiss Re acted as advisor and structured the deal.

It turned out that the major source of risk was weather-related, but on closer examination, it was not explicitly the weather. The explicit part seemed to be more closely related to the volume of grain. In other words, it was an insurance policy with deductibles and limits that combined hazard risks and the grain volume risk. The result was that it gave UGG an additional lever to optimise its capital structure.

Broadening horizons

There is little doubt that risk management has become a very hot topic with the emphasis being on 'broadening horizons'. Interestingly, that was the introductory heading for a series of articles on risk that were reproduced in *The Treasurer*[8]. Within this series of articles, the conclusion to one labelled 'Appropriate Risk', attracted particular attention:

'So what is the appropriate level of risk for a company to take? Every company will have a different appetite for risk depending on sector, strategy, size and maturity as well as a wide range of external and internal factors. Nevertheless, all risks should be identified, prioritised, aligned with strategic goals and then evaluated. If risk appetite can be defined and applied to the business, there is a far greater chance that risks within the business can be more fully understood and communicated. In turn, the extent to which a company can manage each of its key risks will become clearer, leading to far more efficient capital allocations and fewer surprises for the CEO and shareholders'[9].

The points raised by Chapman and Astley might be dismissed as being obvious, but our experience at Henley Centre for Value Improvement (HCVI) is that risk management goes deep to the heart of the organisation and is very broad ranging. Chapman and Astley also raise a very interesting point about the impact of different kinds of risk, and they quote a survey by the management consultancy Mercer that identified the main causes for 100 stock falls over a given period. Strategic and operational issues contributed 89% of the share price falls, while issues reflecting financial and hazard risks made up the remainder. The implications are that advances in risk management will require not only a greater recognition of the convergence discussed earlier, but also looking beyond the conventional functional, subject and organisational silos associated with its identification and management. **MU**

Advances in risk management will require looking beyond the conventional

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Using 'mobile' and 'conventional' markets

As the recent 'technology bubble' has shown, it is easy to overestimate the impact of IT in the marketplace. Nevertheless, marketing via mobile electronic devices does seem to change at least some rules of the game, especially in relation to space and time – think of financial services or book-buying already, for example. The future holds the prospect of using technology more creatively, such as to create new customer experiences, or to update and communicate customer information between devices automatically. **Susan Foreman** suggests that, as a result, some marketing fundamentals, like branding and advertising, need to be re-interpreted within a broader frame of mind.

There is a growing interest in marketing to customers in the 'virtual world'

The 30th anniversary edition of the *Journal of the Academy of Marketing Science* highlights the practical and research implications of serving customers on the internet. This edition reflects the growing interest in marketing to customers in the virtual world. In addition, it seeks to bridge the gap between the huge amount of practical articles in the magazines and in the 'popular press and the practice of internet marketing and sound research based methodical and scholarly insights'. Two articles in particular stand out. Sridhar Balasubramanian, Robert Peterson and Sirkka Javenpaa[1] discuss the implications of m-commerce for marketing, while Richard Watson, Leyland Pitt, Pierre Berthon and George Zinkman's[2] focus on the mobile world and its implications for the future of marketing management. Yet, fascinating though the future of the mobile world clearly is, marketing also continues in more conventional markets. Here, Kevin Keller, Brian Sternthal and Alice Tybout[3] discuss new approaches to brand strategy, while J Richards and C Curran[4] try to redefine the concept of advertising in the modern era.

Mobile commerce brings flexibility to activities once constrained by time and space

'M is for mobile'

The value of these articles lies, clearly, in their holistic approach to m-commerce and attempts to highlight 'challenges and opportunities' for markets and marketing. Rather than focusing on today's or tomorrow's technology, they examine the wider conceptual issues that will help us understand the mobile world and the implications for commerce and the consumer. By doing so, Balasubramanian et al try to develop a framework to help academics and managers understand the potential effects of the mobile world on pricing, location, retail competition and, interestingly, on space and time of consumer behaviour.

Developing a common understanding of m-commerce – and understanding its boundaries – is an important theme of this work: more clarity on this issue will clearly facilitate greater understanding and encourage research. The authors argue that the 'phenomenon' of m-commerce has several distinguishing features:

- communication between people, between people and inanimate objects, and between inanimate objects;
- one 'party' to the communication must be mobile;
- mobile communication must be possible over a sustained period of time and involve significant movements between destinations that are far apart;
- communication signals must be electromagnetic; and
- when people communicate one party must benefit commercially and when inanimate objects communicate there must be a commercial benefit.

Balasubramanian et al, amongst others, view the dimensions of space and time as crucial to understanding the mobile context and build on a long running debate about the economic implications of space and time.

In short, they say, space and time are valuable resources that are in short supply and inextricably linked. Indeed, to explain their relevance they plot a number of activities with time on one axis (ranging from flexible to fixed) of a graph and space on the other axis (ranging from constrained to flexible). They then use this to compare situations with and without mobile technologies. While some commercial activities are not affected by the mobile world, for others mobility provides customers and companies with more options and opportunities in terms of space, time or both. For activities that were once constrained in space and fixed in time, mobility can bring flexibility – book buying from an electronic source and banking/financial services being classic examples.

Balasubramanian et al categorise the different kinds of m-commerce activity based on whether they are location sensitive, time critical and the source of information and its control. This taxonomy, the authors claim, is a platform from which a detailed examination of the different aspects of marketing for academic study and, ultimately, practical guidance for managers can be launched. While a truly mobile world is not yet here, the challenges of m-commerce are, however, creeping into the managerial consciousness and becoming part of marketing decision making. Yet, a great deal more research is required to better inform management decision-making. Indeed, the list of research questions at the end of their article highlights the size of the gaps in our knowledge of 'a phenomenon that is likely to change the current marketing paradigm'.

'U is for uber-commerce'

Watson, Pitt, Berthon and Zinkman take a slightly different perspective and explore in greater detail the dimensions of the mobile world, considering its impact on managers and academics. For them, the dimensions of time and space, and the 'network-driven company', are crucial. Here, exchanges, transactions and communication take place between a number of stakeholders and enable the company to provide an even more efficient basis for delivering quality service to its customers.

The notion of 'bounded rationality' – the customers' limited ability to process the vast amount of information available to make buying decisions – underpins the authors' discussion. When customers' 'boundaries' of information processing are reached, they say, customers need to make compromises. Yet Watson et al suggest that a mobile world of u-commerce, technology and networks – such as the internet – rather than exacerbating 'information overload' could actually be used to relieve the burden and assist in information processing. The authors also extend the use of the term 'u-commerce' which, for a number of years, has simply been used to refer to 'ubiquitous commerce'. They suggest that the 'u' actually stands for über-commerce and that ubiquity is just one characteristic. In other words, the marketer should widen the scope and extent of their thinking to consider the 'universal', 'unison' and 'unique' characteristics:

'U-commerce' could relieve 'information overload' and assist in information processing

- *ubiquity* is largely used here to refer to the future where computer chips, and in the future computer 'flakes', will be used throughout our lives. These are used not only in PCs but also in consumer goods, automobiles, mobile phones and all manufactured goods to make up, potentially, an entirely networked world. Access to the mobile infrastructure to achieve universal contact is currently limited, as different systems are used in different countries. However, when universal systems are developed there will be universal access from personal equipment or from equipment 'borrowed' from others anywhere in the world; and
- *unison* means that rather than 'beaming' between devices to update each one (eg between e-mail and schedules from a PC to a PDA), the different devices used by the customer will be integrated instantly, so that when one updates all will, in unison. It is possible to provide information and messages that are unique to the needs of the customer by learning about their activities and preferences. Thus, information can be tailored, customised and delivered to customers depending on time, location and role ie whether the intended recipient is at work or home, or for business or pleasure.

These characteristics form the basis for the model of 'u-space', where the authors identify four types of commerce (the 'hyperreal', the 'posthuman', the 'matrix' and the 'node') and their corresponding approaches to marketing ('immersion marketing', 'transformation marketing', 'nexus marketing' and 'sync marketing').

'U-space' gives rise to new approaches to marketing

Hyperreal commerce
In the future, hyperreal activities will build on our consciousness and develop computer-generated virtual worlds. This leads to

Will marketing in the physical/ conventional marketplace still challenge marketers?

immersion marketing which, according to Watson et al, includes the 'processes that combine the extension or enhancement of the individual's or collective's consciousness'.

Posthuman commerce
At one level, this type of commerce will extend our ability to process information and help us manage 'bounded rationality'. At another level this, according to the authors, can lead to the development of prosthetics and, ultimately, the 'cyberhuman'.

Here, the marketing approach is through transformational marketing where the consumers' abilities can be extended and where 'mind-machine interfaces will allow electronic implants that will facilitate the enhancement of memory computation and communication.'

The matrix
Technology itself performs tasks on behalf of the customer through an integrated network of the internet, cellphone, GPS and so forth. Here, the marketing approach is termed 'sync marketing', reducing the need for customers to perform routine activities such as updating information. Thus, customer information is automatically updated in unison across a number of locations without further customer intervention.

The node
Commerce here is more conventional and includes 'automatic' updating of repeat purchases. These activities are low risk or low priority and customers are content to leave them to technology to update. The marketing approach is called a nexus approach. This enables marketers to anticipate the needs of customers and this, according to the authors, resembles customer relationship management where they 'understand individuals so well that their offers add unique value to the prospective customer', thus increasing switching barriers.

There is a need to understand the business as it changes

Clearly, the literature examining mobile marketing is growing, but very little is written about its relationship with conventional marketing activities. This seems surprising, given the integrated approach which seems to be a core feature of marketing in a mobile environment. Does this mean that marketing in the physical/conventional marketplace no longer challenges marketers?

'B is for branding'

Clearly, it still does, and despite the rapid growth in e-, m- and u-commerce, many managers are still striving to manage brands in more conventional marketplaces. In another article, Keller – a renowned authority in the branding area, together with his equally influential colleagues Sternthal and Tybout – challenge some accepted brand management practices. They ask managers to question their current approaches, suggesting they should first look at similarities before, as is common, they examine the points of differentiation between brands. For them, there are three key branding questions. First, do managers truly understand the frame of reference (or context) of the brand? Second, are they leveraging the points of parity? Finally, are the points of difference compelling?

Do managers understand the frame of reference of the brand?
Asked most pointedly by Theodore Levitt in the classic article, 'Marketing Myopia' in 1960[5], Keller, Sternthal and Tybout also remind managers to consider an obvious but often overlooked question – what business are they actually in? By defining their business too narrowly, many managers, for example, fail to see changes in the marketplace and the concomitant threats and opportunities. More important, however, is the need for managers to define a clear frame of reference to identify their competition and, thus, those against which they should differentiate themselves. For instance, the authors quote Federal Express who established themselves in the mail business with their point of difference being guaranteed overnight delivery. Years later, however, this promise of speedy delivery can't compete with the new competition from email. Thus, for this company at least, a new point of difference is needed. In essence, the authors reiterate the need to understand the business, now and as it changes, and the need to refocus as markets mature and develop. This understanding will, therefore, allow managers to make judgements about the points of parity and points of difference.

Points of parity
The frame of reference provides a defined boundary, or a context, for identifying what Keller et al refer to as the 'points of parity.' These are the key characteristics of the brand that consumers can readily compare

with similar products, and which will reassure customers that the brands are true competitors. This is particularly important for new brands. For brand extensions, the first step is to emphasise that it can perform the function for which it is intended, and then, as it establishes itself, it is possible to emphasise the points of difference. For established brands it is necessary to review the approach as brand positions are not permanent or guaranteed, and differentiators can in time become the accepted standards.

Points of difference

Brand managers must, therefore, be clear about the business they are in and the brand must be clearly established before the points of difference are then emphasised. Typically, these can be based on performance, imagery, or the solutions and the benefits the consumers demand.

Thus, these three dimensions can provide the framework for the 'messages' used when marketing products. But, according to Keller et al, the company's position in the marketplace also has an important effect on the strategy which can be pursued. For example, market leaders such as Coca-Cola can send top level messages based on the frame of reference, ie 'Coca Cola is refreshment' whereas competitors might position themselves based on points of parity or difference. According to the authors, success can be achieved by a company 'attacking a competitor's point of difference, recasting it as a point of parity… hop[ing] to draw attention to its own point of difference'. This, though, is straightforward neither in theory nor practice!

'A is for advertising'

What is a good contemporary definition of advertising? As changes have taken place in the marketing world, new techniques in communication have emerged and existing ones have developed. Where advertising was once synonymous with marketing, is it now positioned further away in the wider marketing arena? Has advertising now become the 'catch-all' term for anything related to marketing communications? Richards and Curran, in trying to develop just such a new and appropriate definition, assert that there is no recognised or universally accepted definition of advertising, and many textbooks and articles vary in their approach, as do the business dictionaries and the advertising professionals. Indeed, their article explores no less than 24 alternative definitions of advertising. For them, this is no trivial matter: definitions have professional, legal and academic implications, especially if Keith Reinhard[6], the chairman of DDB, was correct in 2001 when he stated that advertising was at the edge 'of a new golden age… if we are willing to broaden its definition'.

Marketing and advertising were once synonymous, but changes have occured

In fact, the authors' discussion is intended to be a starting point in the wider debate on the nature of advertising. They use an interesting research technique called the Delphi method, where they survey an expert panel repeatedly to try and coax consensus on the definition. The Delphi method works as follows.

In the first phase of the research, Richards and Curran offered a definition of advertising and questioned the experts about their views of this and how it might potentially be developed. The second phase questioned the experts about the scope of advertising and gauged to what extent they thought that advertising should be redefined. Their suggestions, which broadened the scope of advertising, then led to a third and final stage where the suggestions set out were tested once again. The definition of advertising which they developed states that, 'Advertising is a paid, mediated form of communication from an identifiable source, designed to persuade the receiver to take some action, now or in the future'. The 'mediated form' to which they refer is 'print, electronics, or any method other than direct person-to-person contact.'

There is no recognised universal definition of advertising. Debates about branding continue unabated

Before this consensus could be achieved, of course, the Delphi method generated a large array of different views. Nevertheless, the value of the agreement was clearly in helping to provide boundaries and a common language for researchers, academics and professionals. Yet, given the nature of academic debate, this may well be the start of further argument and discussion!

Thus, there continues to be a great deal to discuss in the conventional world of marketing, a discipline that has been developing for many decades. Debates about branding and advertising continue unabated. Indeed, the work on mobile marketing has just started in earnest and, for now at least, suggests more questions than answers for both academics and managers. **MU**

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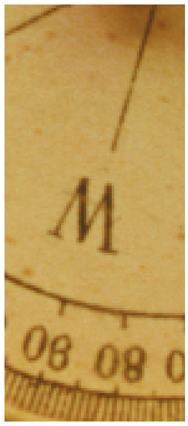
The challenge of call centres



Have call centres become 'electronic sweatshops'? Do they exhibit the old features of human resource managemernt (HRM), such as the strict control and little flexibility of a mass production system, or is this a misinterpretation of a new model based on service quality and customer orientation? Not all call centres are the same; they vary according to the type of market and the HRM philosophy that underpins them. Here, **Richard McBain** says that trade-offs have to be considered – quality versus cost, service versus surveillance and commitment versus control.

In Europe and the US, between 1% and 3% of the workforce may now be employed in call centres[1] and such units also now handle around two-thirds of all customer interactions[2]. Call centres, clearly, are here to stay, and are becoming an increasingly popular means of delivering customer service. To their supporters they represent cost-efficiency through centralisation, rationalisation and the application of technology. Their growth, however, also raises interesting HRM questions about, for example, the application of 'Taylorist' scientific management principles to customer service delivery, especially when customer expectations are increasingly sophisticated, and many manufacturing industries seem to be moving away from such practices.

Indeed, to their detractors, call centres have been seen as 'electronic sweatshops'[3]. Some, for instance, raise eyebrows at an employment relationship that involves control mechanisms such as scripted conversations and intrusive performance measurement. Call centres may also give employees less discretion and autonomy, precisely at a time when HRM theory stresses the beneficial consequences of high employee commitment and empowerment. The nature of work in call centres thus provides a useful context for the study of 'emotional labour', which involves the eliciting or the suppression of particular emotions. Call centre work has been regarded as having potentially adverse consequences for job satisfaction and employee well-being, which in turn may lead to higher employee turnover and absenteeism.

However, as Stephen Deery and Nick Kinnie[4] note in their introduction to a recent special issue of the Human Resource Management Journal, while call centres may be distinctive in terms of their demands upon employees, there is still no detailed and systematic understanding of the management practices and outcomes of call centres. This Manager Update, therefore, considers recent research into the HR implications of call centres.

Call centres provide a useful context for the study of 'emotional labour'

Call centre production models and human capital formation

Although many call centres may look similar, not all operate in the same way. R Batt and Lisa Moynihan[5], for example, identify three alternative production models that may be used in call centre management. Each involves different levels of investment in human capital:

- mass production;
- mass customisation; and
- professional services.

The classic 'mass production' model aims to maximise volume and minimise cost, through combining mechanisation and the minimisation of skill requirements, discretion, job cycle time and learning. This model has been typically applied in manufacturing, but now, thanks to technology, is also often applied to service and sales interactions. Batt and Moynihan argue that call centres, in fact, represent one of the very few cases in which mechanisation has spread into customer contact work. In contrast, the 'professional services model' lies at the other end of the HR investment scale, with the goal of providing quality service. Here, technology complements labour, and employee skill levels, discretion and rewards are all high. Between the two models lies a hybrid model that Batt and Moynihan term 'mass customisation'. This model seeks to compete on quality, customisation and price. Some automation is combined with attention to service quality and customer loyalty.

Although call centres may look similar, not all operate in the same way

Batt and Moynihan examine whether 'high involvement' practices – which have led to improved performance in manufacturing – can also lead to improved performance in 'mass production' call centres. High involvement practices require three elements:

- investment in skills;
- work design that allows employees the opportunities to use those skills; and
- incentives that reward effort and commitment.

High involvement practices may work 'affectively', by influencing employee attitudes and motivation, as in the 'service profit chain' argument. Alternatively, they can work 'cognitively' by influencing employees' skills and their ability to learn and solve problems on the job, either individually or in teams. The rationale, therefore, is that providing individual workers (or work-groups) with greater discretion should improve problem-solving skills and thus, in turn, lead to continuously improved production.

The authors, drawing on data from two studies, found that production models varied by customer segment. The first study, of call centres in the US telecommunications sector, found, for example, that residential customers were more likely to be served by a mass production model, large businesses by a professional service model, and small businesses by an intermediate or hybrid model. Also, they found that within the residential mass market, centres that adopted higher involvement strategy had more than twice the employee quit rates and twice the sales growth of those which adopted a lower involvement strategy.

Production models used in call centre management vary by customer segment

A similar pattern existed for the small and large business centres, although the effects were smaller. In the second study, they found that team-based work systems in call centres have a different meaning to those in manufacturing settings. For instance, being in a call-centre team doesn't significantly alter the nature of the work itself, as in the case of job rotation, nor does the technology require collaborative working. However, the collaborative structures created by employees and supervisors do provide the opportunity to improve skills and abilities through sharing information and learning from other colleagues.

While high involvement practices seem to be rare in the more cost-conscious markets, they may nevertheless confer value because employees are better able to meet the demand for customisation and the bundling together of multiple services. In addition, collaboration and knowledge sharing may lead to higher call quality, innovative problem solving and peer learning, lower call-handling time and greater job satisfaction. This thesis is further developed by Batt[6] who argues that high involvement HR practices allow a business to build company-specific human capital, ultimately leading to better performance. This capital is built as employees develop their knowledge of a company's products, customers and work processes, allowing them to interact more effectively with customers. Or, alternatively, it is built indirectly through employee attachment to the company and lower employee quit rates.

The relationship between high involvement practices and sales growth is influenced by the identity of an establishment's primary customer base. High involvement practices are associated with higher sales growth in call centres servicing small businesses and residential centres, while for those servicing large businesses such practices appear to be the price of entry.

Here, they affect sales growth – primarily but indirectly – through quit rates. These findings are consistent with a resource-based view of the company. High involvement practices are rare in more cost-conscious markets and, therefore, may confer more value. However, this research also suggests investing in high involvement practices may not always pay off, such as when there are limited opportunities for sales growth in a particular market.

Low discretion/high commitment human resource management

Call centre management involves a tension between cost and quality. Maeve Houlihan[7] argues that in call centres there is often a paradoxical human resource management strategy, involving low discretion and high-commitment (LDHC). In a study of four call centres she found that organisations may adopt different LDHC approaches, and she proposes a typology of possible LDHC models differentiated by their position on two dimensions. One dimension examines the organisational assumptions underlying the business' use of high commitment techniques. For example, is it really based on a comprehensive commitment approach or on a superficial one whose aim is really control? The other dimension focuses on work design. Is low-discretion work implemented effectively to coerce employees or does it, in fact, support their work? Four types of LDHC approach are identified:

- *containment* – combining control and coercion. This sacrifices high commitment management to performance objectives and probably requires a job market that offers limited alternatives to employees;
- *alleviation* – combining commitment and coercion. Whilst this model involves a significant investment in cultural support and the symbols of commitment, there are highly formalised policy procedures, minimal employee discretion and task-focused supervision;
- *structured employee development* – combining control and an enabling work design. This is 'hard HRM', emphasising cultural controls and individualised psychological contracts, with methods to support employees through training, for example; and
- *involvement* – combining commitment and enabling work design. This is 'soft HRM', which also involves a radical re-appraisal of job design, staffing levels, task mix and types of behaviour offered by and expected from customer service representatives.

Houlihan's research suggests that the systematic and thorough use of commitment techniques in call centres may be relatively rare. Often, though, these techniques may be used to minimise some of the negative consequences of call centre work. Again, Houlihan's research highlights that not all call centres are the same and that different approaches may be taken, depending principally on the specific competitive contexts of the organisations, and, in particular, business strategy and the labour market. LDHC approaches, however, are undermined by a series of conflicts that are likely to lead to mixed messages, raised expectations and, ultimately, frustration through unkept promises:

- treating people as machines while claiming they are valued;
- wanting control while seeking contained initiative and flexibility; and
- promoting an atmosphere of trust while utilising technologies of distrust.

Like Batt and Moynihan, Houlihan asks why more coherent approaches to high commitment management are not more widespread in call centres. Commitment models, for example, may be more effective and less costly than control models. Perhaps the reason lies in their design, which is rooted in the control paradigm, she argues. Consequently, commitment approaches merely modify rather than overcome a control strategy.

Call centre management involves a tension between cost and quality

Emotional exhaustion and employee withdrawal

Call centre work involves customer service representatives in both cognitive and emotional labour. The latter area, in particular, is an increasingly important area of research. Stephen Deery, Rick Iverson and Janet Walsh[8], for example, have examined how both the job and the call centre work environment affect the incidence of emotional exhaustion and employee withdrawal. Emotional exhaustion is characterised by fatigue and the depletion of an individual's emotional resources. A number of factors are linked to emotional exhaustion within the call centre context:

- abusive and demanding customers;
- a dislike of 'scripted' conversations;
- repetitive jobs;
- excessive workloads;
- focus on the quantity of calls rather than the quality of the service;
- lack of skills;
- limited promotional opportunities;
- length of tenure – employees with a longer tenure were more likely to feel emotionally drained by their work, but were less likely to take one or two-day absences.

By contrast, spending longer on customer calls and supportive team leadership were associated with lower emotional exhaustion. Yet, personal factors also impacted on perceived emotional exhaustion, including, for example, a positive disposition towards life and work and a perception that one's general physical health was good. Those employees who felt emotionally drained were more likely to take a larger number of one and two-day absences from work. Interestingly, employees who displayed high levels of positive affectivity were more prone to withdrawal behaviours. Full-time and female workers had significantly higher rates of one and two-day absences. Those with good physical health experienced fewer absences, as did employees with higher educational levels and longer tenure. Thus, this research suggests several important

The nature of the work may affect the incidence of emotional exhaustion and employee withdrawal conclusions. First, the employee/customer relationship can be a source of both emotional exhaustion and of satisfaction. Second, team leaders can have a significant impact on emotional exhaustion levels; employers should therefore encourage a more supportive and self-reliant management style amongst team leaders.

Finally, the results also question the reliance on selecting employees based on perceived personality traits, such as extraversion. For instance, while employees with high positive affectivity may be less prone to 'burn out', they may also have higher expectations of intrinsic rewards from their work. Non-fulfilment of these needs may then lead to disappointment and greater absenteeism. Consequently, environmental conditions may be more important than personality.

Recruitment and developing attitude

Environmental conditions may be more important than the selection of employees based on personality (traits)

In a case study at the 'Telebank' company, G Callaghan and Professor Paul Thompson[9] examine the approach to selection used by managers with employee experiences of selection, training and work. Call centre work, as noted above, drives managers to seek certain personality characteristics and social competencies – rather than mere technical skills – in potential recruits. These include:

- a positive attitude;
- a sense of humour;
- vocal qualities of tone, pitch and warmth; and
- energy and enthusiasm.

The primacy of such attributes was, moreover, also recognised by the customer services representatives themselves. Interestingly, however, they were more likely to view these requirements as necessary for surviving stressful and repetitive work, rather than with being essential to pursuing customer service enthusiastically!

The authors identify a double paradox in the company's experience of selecting and shaping its labour force. First, the structure and process of systematic selection and training was in contrast to the routine jobs, modest pay and flat promotion structures at the company. As with Houlihan's LDHC model, investment in recruitment and training is consistent with high commitment and high performance HRM, yet the work itself had few of the characteristics of high performance work systems. Unsurprisingly, perhaps, 'Telebank' – like most of its competitors – suffers from high turnover levels. The second paradox is even more obvious. Recruiting people based on personality and 'social' competencies, including communication skills, is highly likely to produce tension if these people must then adhere to scripts and other techniques of conversational control at work. Indeed, while the training emphasised rapport with the customer and call quality, the work itself was more focused on call quantity.

The concept of 'emotional labour' is used to understand the tensions and conflicts arising from this double paradox. While conflicting emotional pressures may explain some of the negative behavioural outcomes facing the industry, the concept also questions the common picture of call centre employees as self-disciplined subjects of electronic surveillance.

Customer services representatives are active agents, aware of managerial demands, but also capable of adopting their own conceptions of appropriate emotional labour. This case study shows that the 'mixed messages' received by employees reflect the complex tensions within call centres between the demands of quantity and quality. Organisations need to address the problems of low morale, high turnover and poor external image. Some, of course, may choose to live with the status quo; others will lessen surveillance and extend discretion. In part, technology such as the internet may help, for example by handling more routine transactions.

Are call centres really such a bad case of managing resourceful humans?

The final article considered in this Manager Update does, however, cast doubt on simplistic generalisations about call centre work and its impact on customer service representatives. David Holman[10] examined the effects of job design (control, variety and workload), performance monitoring, certain HR practices (including payment fairness, performance appraisal and perceived training adequacy) and team leader support on four measures of employee well-being: anxiety, depression, intrinsic job satisfaction and extrinsic job satisfaction. The study involved customer service representatives in three different call centres of the same UK bank.

Unsurprisingly, a high level of monitoring had a negative effect on employee well-being, potentially leading to depression and inactivity in the long term. By contrast, greater autonomy and variety had a positive impact on job satisfaction. Furthermore, control over how to talk to customers, and how to do a work task, was considered more important than having control over the actual timing of a call.

As with the research of Deery et al, actively attending to, and meeting, customer needs and dealing with their problems may prove satisfying as well as a source of anxiety. A supportive HR and leadership environment also had a significant impact on employee well-being. The greater the payment fairness, the perceived usefulness of performance appraisal and training adequacy, the higher perceived levels of job satisfaction and lower the experience of depression. Team leader support was also very important.

In terms of well-being, Holman argues, these results may suggest call centre work compares favourably with shop-floor manufacturing and clerical work. Accordingly, call centres may not be that radically different from other forms of work organisation from which, moreover, lessons could be learned and successfully applied. In particular, this research identifies three key means for improving employee well-being:

- high employee control over work methods and procedures;
- low levels of performance monitoring; and
- a supportive team leader.

The importance of the team leader is a recurrent theme in much of the research considered here. A key recommendation from Holman's work is the need to invest in the training of team leaders, particularly with regard to the administering of performance appraisal and the development of a facilitative and supportive style.

The importance of the team leader is a recurrent theme in call centre research

Conclusion

Characterising all call centres as 'electronic sweatshops' may be mistaken, but the research considered in this Update suggests that, in the mass production model at least, it isn't too far wide of the mark. Furthermore, the research, whilst noting the impact of business strategy and contextual factors on the choice of call centre model, questions both the necessity and the supposed benefits from the application of scientific management to service provision.

If this research is correct, a number of tensions exist within this approach: quality versus cost, service versus surveillance, and commitment versus control. Call centres will need to find a way to manage these tensions, and this may need a radical reappraisal of their approach to HRM. **MU**

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Learning from experience

It is well known that most acquisitions fail to generate business value, yet their popularity remains unabated over the long term. Don't businesses learn from their experience? Rarely, it would seem, except in special circumstances, depending on the culture of the company, how similar the acquisition is to the core business and how frequent they are. Learning from experience can also be impeded by rigid organisational structures, especially when seeking opportunities internationally. But, as **Ian Turner** writes, learning from past experience is not always a good guide to the future. There is no substitute for a clear, coherent, competitive strategy.

It is axiomatic that in most fields of human activities the more times an operation is repeated, the more efficient and effective we become at carrying it out. In the 1970s and 1980s, this principle was elevated to a doctrine of business strategy – the so-called 'experience curve' – which posited a direct relationship between market share and profitability, on the grounds that a company which had expanded its turnover more quickly than its competitors would learn how to deliver a better service at a lower cost and therefore be more profitable.

There are contradictions inherent in the literature of acquisitions

Arguing from a different perspective – that of total quality management – Japanese management theorists coined the term 'kaizen', generally translated as continuous improvement, to signify a ceaseless quest for incremental gains in operational efficiency. Yet, not everything in life seems to be susceptible to the principle of the 'learning curve'. With a view to the divorce statistics, marriage has sometimes been described as a 'triumph of hope over experience' and similar sentiments are often invoked by the literature on acquisitions.

In a recent contribution to this literature, Mathew Hayward has assessed the evidence on whether firms learn from their acquisition experience to improve their chances of getting it right[1]. Hayward is clearly fascinated by the contradictions inherent in the literature of acquisitions. On the one hand this literature has, with almost monotonous regularity over a period of more than 20 years, informed us that most acquisitions fail to generate business value. At the same time, the popularity of acquisitions (although admittedly cyclical) remains over the long run unabated, fuelled not least, by prominent cases of successful serial acquirers like Hanson in the 1980s, General Electric and, latterly, Cisco Systems.

Hayward comes at this problem from an organisational learning perspective, which has the interesting consequence of generating conclusions that may have relevance for other areas of strategy where organisational learning is of importance. His starting point is that companies who engage in acquisitions over time have the potential to learn from this process to become better at selecting the right acquisition in the first place and generating superior returns. That this experience frequently fails to engender beneficial effects is due to a number of causes, according to Hayward.

First, acquisitions, although often regarded as homogeneous phenomena, are individually often very different. A moment's reflection will, of course, confirm that acquisitions differ not least according to:

- the reasons why the acquisition is undertaken in the first place;
- the aspirations for the acquisition; and
- the levels of similarity between the companies and the respective size of the companies.

All these differences can frustrate effective organisational learning.

Second, the propensity of management to look for lessons from past experience depends on the extent to which prior acquisitions are viewed as successes or failures and thirdly, for many companies acquisitions occur so infrequently that inferences are either not made or the learning is lost because of turnover of employees, etc..

Hayward's basic model is the inverted u-curve. Thus, if we take the first of his three central arguments – successful learning, he maintains, is likely to occur when the businesses acquired previously are neither too similar nor too dissimilar to the company's business. Similarly, management's propensity to examine the lessons from previous acquisitions is highest in cases where the acquisition has generated a small loss and conversely, much weaker where a prior acquisition has been judged a major success or a major failure.

Finally, the timing of acquisitions is critical. Beneficial effects are produced when the intervals between acquisitions are neither too short (not long enough for the company to take stock properly) nor too long (lessons become forgotten or obscured by the passage of time). On average, acquisition intervals of between six and 12 months are likely to be optimal.

The happy medium

Hayward is essentially arguing for the 'happy medium' in acquisitions as in other areas of organisational learning. He illustrates this with a reference to examples of companies which have fallen victim to one or other of the extremes. Thus, a company like BancOne was an aggressive acquirer of regional banks in the US in the early 1990s but converged at an early stage upon a particular formula for identifying and executing acquisitions and developed highly specialised routines. As a result, it failed to expand its strategic repertoire. 'Ultimately the acquisitions resembled a recipe-like strategy that failed to keep pace with new competitor-led initiatives' [2].

In other words, there is merit in having diverse experience in acquisitions as with other things in business life. However, you can have too much of a good thing. Companies like AT&T, which used acquisitions to pursue diversification strategies, are also vulnerable. 'Acquiring a series of highly dissimilar businesses helps firms to discover new bases of knowledge and experience but prevents specialised learning about any one business. If these firms make another diverse acquisition they become even more administratively stretched and incoherent.' [3]

Failing to learn

Hayward also hypothesises that successful learning from acquisition experience is related to the number of small losses which a company has generated through prior acquisitions. This is based on the assumptions that large failures will so shock a company as to deter it from making serious forays into acquisitions and, successful acquisitions provide no incentive to managers to improve performance. This is an interesting theory but not very helpful from a prescriptive point of view. Urging companies to conduct as many small scale failures as possible prior to engaging in an acquisition is unlikely to catch on as a principle of management practice nor is it altogether clear why minor successes in prior acquisitions should not have a similar impact upon acquisition performance.

There is merit in having a diverse experience of making acquisitions

At the end of his article, Hayward speculates that the results of his study may have applications for other areas of strategy such as alliances, joint ventures and international market entry. Thus, presumably, one might hypothesise that companies are most likely to be successful if their growth strategy eschews, on the one hand, mindless diversification and on the other hand, relentless focusing on core business, but adopts instead a concentric diversification approach. In passing, we might also note another interesting aspect of Hayward's research into acquisitions. He discovered that there was a negative correlation between the use of investment banks and the performance of an acquisition! Hayward speculates that firms who use banks are either less capable in the first place or else are hoodwinked by banks into overpaying for deals because banks are paid on the basis of a percentage of the deal value.

Beyond the business unit

Focus and diversity is also the theme of Eisenstat et al's article, although this time the emphasis is more on internal coordination[4]. In this article, based on research into large international companies, the authors look at how such companies have sought to resolve the dichotomy between achieving the sort of organisational focus exhibited by smaller entities whilst realising the economies of scale and scope possessed by large corporations. Their label for the solution that such companies adopt is 'opportunity-based design'. The notion here is that in large, sophisticated, internationally operated companies like ABB and Citigroup, which also serve sophisticated, international customers in some cases, resources must be mobilised across the organisation and cannot be constrained by traditional organisational structures.

Organisations need to be able to respond rapidly to opportunities

Of course, much of this is not entirely new. Companies have had key account managers and cross-functional project teams for 20 years or more. Nor are the authors arguing that companies – even of this size – should dispense with traditional business unit type structures. They seem, however, to be proposing a more informal superstructure, superimposed upon the traditional structure, which enables organisations to take advantage of and to respond rapidly to opportunities for which the organisation needs to mobilise all of its resources.

A key component of this approach seems to be an 'electronic' management system, analogous to the more common CRM systems and databases. Thus, at IBM for example, all employees can register opportunities on the company's opportunity management system. Of course these days it should be easier – at least in theory – for companies to make information available digitally at very low cost and enable individuals across quite disparate organisations to collaborate more effectively. Even with such systems, however, there is clearly still a daunting challenge facing so-called opportunity owners, deep in the bowels of large organisations. They have not only to identify the key resources they need to exploit their opportunities, but they must also persuade the gatekeepers of such resources to release them. Arguably, it should be possible for opportunity owners and resource gatekeepers to negotiate win/win deals in such circumstances. But corporate policies and patterns of incentives can often defeat the best of intentions and in some circumstances, such as the Citibank example mentioned in this article, the company's chief executive officer has to intervene in order to break a logjam and enable opportunities to be exploited appropriately.

For complex structures to work, employess need to tolerate high degrees of ambiguity

Ultimately, I guess this reinforces the conclusions of the literature on trans-national solutions to international business[5] that for these complex structures to work effectively, employees need to tolerate high degrees of ambiguity. A culture which is pre-disposed towards give and take, over a longer period of time, is likely to be more conducive to exploring such opportunities. As Eisenstat et al point out 'managers at ABB and at Citigroup know that the game has many rounds: if they make undue demands for resources or negotiate in bad faith, they will damage their reputations and prejudice their chances of prevailing in the future'[6]. It would appear, however, that for such opportunity designed structures to work properly, a fair degree of accountability and organisational power needs to be devolved, albeit temporarily, to customer teams or project teams or whatever other designation is used.

Integrating the enterprise

The issue of horizontal integration amongst international companies has also occupied Sumantra Ghoshal and Lynda Gratton[7]. Although Ghoshal and Gratton recognise that this is not a new problem, they maintain that the nature of the problem has changed. On the one hand, the advent of the digital economy has allowed companies to disaggregate their value chain and integrate operations in ways that would have been unthinkable even five years ago. But at the same time, older integration devices such as the personal networks which career executives built up over a lifetime of working for a particular corporation have been eroded by the changes in the nature of employment and increased mobility in the labour market. They identify four critical areas where leading international companies have integrated their operations horizontally:

- *operational integration* – achieved through standardising technological solutions and infrastructure;
- *integration of intellectual property* – through the application of knowledge management systems;
- *social integration* – through what the authors term 'the collected bonds of performance' which, to judge by the example quoted of BP, seems to consist largely of peer review of performance and capital investment decisions; and
- *emotional integration* – or the commitment

to common values which can act as 'corporate glue' in the absence of the more traditional command and control type approach.

In principle, of course, this horizontal integration approach appears to be very attractive. It stimulates entrepreneurial activity, devolves autonomy and responsibility for business performance down the organisation, eliminates several staff and functional units and replaces them with peer-assist project groups. But, as the authors point out, the results of successful horizontal integration take time to achieve.

They maintain that there is a powerful, symbiotic relationship between devolving authority on the one hand and integrating activities horizontally on the other hand, and that once the results start to appear in terms of superior business performance, this has a powerful effect in reinforcing group norms and behaviour. Nevertheless, even in the examples cited by the authors, this process typically took around two years. Vertical integration and top-down control is quicker to implement, but horizontal integration promises, they believe, to deliver self-sustaining organisational capability.

Whatever happened to business models?

The term 'business model' was one of the great buzzwords of the dot-com era. Every budding internet entrepreneur had a 'business model' and many of the most ambitious seemed to involve consumption of vast piles of cash in a 'hell for leather' attempt to attain market dominance on the web. The term 'business model' soon became discredited. As Joan Magretta[8] points out, this is a great pity because at the heart of many successful businesses is a robust business model which explains how value is generated for the customer at a cost which can enable the company to make sustainable returns on its investment. Tellingly, Magretta uses the example of American Express and the invention of the travellers cheque more than 100 years ago to illustrate her point.

The travellers cheque, which emerged out of the personal experience of American Express' founder travelling to Europe at that time, was designed to meet a pressing need amongst travellers. For a small up-front fee, the travelling public could ensure themselves against loss and theft and have confidence that wherever they went the cheques could be encashed for local currency. As with many of the successful internet business models, there were strong 'network externalities' driving the success of the travellers cheque. Banks, hotels and retailers would accept the cheques because they were underwritten by the American Express brand but also because, by advertising their acceptance, they stood to attract more customers. This, in turn, exerted a powerful compulsion on other traders not to be sidelined which, in turn, accelerated the development of the network and encouraged more customers to use travellers cheques. Once established, the beauty of the travellers cheque system was that American Express was able to use its reputation and the trust it engendered to develop a powerful profit-making machine. More precisely, as Magretta points out, the twist in the business model was the concept of 'float'. In most businesses costs precede revenues: before anyone can buy your product you have to build and pay for it. The travellers cheque turned the normal cycle of debt and risk on its head. 'Because people paid for the cheques before (often long before) they used them, American Express was getting something banks had long enjoyed – the equivalent of an interest-free loan from its customers. Moreover, some of the cheques were never cashed, giving the company an extra windfall.'[9]

A robust business model is at the heart of many successful businesses

Furthermore, as Magretta points out, the travellers cheque example exemplifies another feature of truly successful business models. It created a new market in this case, by reducing the risk of travel it promoted the development of foreign commerce and tourism.

To be enduringly successful, a model has to be difficult to emulate

To be enduringly successful, a business model also has to be difficult to emulate. Travellers cheques are not exactly a natural monopoly. Nevertheless, American Express enjoyed significant first-mover advantages by being able to develop its network before other players were able to come into the market. This element of sustainable, first-mover advantages seems to be the key to the long-run success of a business model although, as we have argued in previous Manager Updates[10], many alleged first-mover advantages are these days rapidly eroded by fast-followers.

According to Magretta, the mark of a successful business model is that it meets two tests: the narrative test (does the story make sense?) and the numbers sense (do the economics add up?)

From the benefit of hindsight, it is easy to see that some of the web-based business models failed the narrative test: it was never really plausible that huge numbers of consumers would wish to buy pets on-line for example, whereas other business models, eg business-to-business exchanges, seemed ultimately to have failed the numbers test. The most successful of these dot com models – like the much praised e-Bay – seem to have developed on a successful business model derived from the fact that the service they offer could not easily be performed without the benefit of the web.

Strategy versus business models

A business model is not the same as a strategy

A business model, as good it might be, is, however, not the same as a strategy. A business model may describe how value is to be generated and captured but, critically, it does not define how the organisation copes with competition. Drawing heavily on Porter, Magretta emphasises the importance of companies doing things differently from competitors. Thus, there was nothing unique about US retailer Walmart's business model. Indeed, the business model itself was largely derivative of other stores like the now defunct K-Mart. What was distinctive in the case of Walmart was its strategy: ie basing the stores in small towns largely neglected by the competition and offering consumers major brands at everyday low prices. These strategic decisions created a competitive position which was difficult to imitate and which preserved first-mover and experience-curve advantages.

Of course, a new business model can, for a time, provide a source of competitive advantage but there are now many low cost retailers, 'no frills' airlines and direct sellers of computers. The business models in each case are almost completely transparent, yet successful strategic positioning will ultimately determine the difference between success and failure no matter what the business model underpinning it is. **MU**

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