THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND & WALES

The Institute of Chartered Accountants in England & Wales

Faculty of Finance and Management

Finance & Management

Issue 75 MAY 2001

The rise and rise of intellectual capital

Why Göran Roos believes a new science is developing

page 3

THE NEW AGE

Defining the new 'e' generation

page 16

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How to find 'knowledge management' on the web

These web sites may be useful sources of knowledge management information:

Knowledge Management Resource Centre – comprehensive site listing all aspects of KM (complete with links) from basic introductory sources through to specialist university KM research units. Among the most useful aspects of this site is a listing of internet sites detailing case studies of corporate use of knowledge management today.
www.kmresource.com

Sveiby Knowledge Management – authoritive site providing tools, research and advice on knowledge management with an excellent FAQ (frequently asked questions) page and an impressive library of full text articles arranged in sections on concepts of knowledge and information, managing knowledge organisations, measuring intangible assets and marketing and selling knowledge. Also includes a concise definition of knowledge management, complete with details of 40 worldwide initiatives which the author has selected to exemplify 'how companies create value from their intangible assets'.
www.sveiby.com.au

Knowledge Management Magazine – on-line home of *Knowledge Management* magazine with monthly sections on knowledge management in the vertical sectors, interviews with leading figures, book reviews, tools of the trade and a site-watch all available on-line. A news feed from individual.com provides a supplement to the monthly magazine news.
www.kmmag.co.uk

● *The ICAEW Library & Information Service has a series of Knowledge Guides on its web site (www.icaew.co.uk/library.htm) – and recently added a new 'Euro guide' with timetable, links, sources, reading list etc about the single European currency.*

Farewell and thanks to Jacqui

Jacqui Newell has decided not to return to her job as Services manager for the Faculty following the birth of her baby, Callum.

Jacqui arrived in 1993, when the Faculty was in its early days, and since then has worked with us to build the organisation. In the last eight years she has met many Faculty members at events and spoken to countless thousands on the telephone. I have received letters, emails and phone calls from members reporting back on how helpful she has been.

She never lost her cool in all the time I knew her and always had time to help her colleagues as well as the members. She was always great fun. On behalf of the Faculty membership, the Committee and the Faculty team I would like to thank her for her work and friendship and wish her well in the future.

CHRIS JACKSON

Faculty faces

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May 2001 Issue 75

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

ABSTRACT – LIBCAT

Cooper J – Turning knowledge into value
CMA Management, Vol.74. No.8. October 2000: p23-27 (5 pages)
● *Looking at biotechnology firms across Canada, this article discusses how to obtain the maximum return on investment from research and development, and the importance of protecting a company's intellectual capital through patents. Also important is to link business development activities with research and development activities, in order to enhance intellectual capital value. Includes two mini case studies.*

www.icaew.co.uk/library.htm
This abstract is taken from the ICAEW Library catalogue, LibCat, which is accessible from the Library's web site. Books can be lent (by post) to ICAEW members and photocopies can be supplied, at a reasonable charge, within the limits of the copyright laws. Further information about Library services (including access for non-members) can also be found on the web site.

Putting the ‘intellectual’ with the ‘capital’

Widely acknowledged as a key founding member of the intellectual capital ‘movement’, **Göran Roos** (*left*) is a visiting academic on the subject at both Helsinki School of Economics and Mount Eliza Business School in Melbourne. He is also the founder and chairman of London-based Intellectual Capital Services Ltd (ICS). He is a fervent advocate of treating intellectual capital as a valuable asset capable of producing competitive advantage. Helen Fearnley reports.

Ask any major management consultants to name the leading thinkers on intellectual capital (IC), and it’s a sure bet that Göran Roos will be near the top of their list. Certainly he was one of the first people to give the subject an academic grounding: his myriad books, academic papers, and lectures on the subject, as well as a globe-spanning raft of intellectual capital-based visiting professorships and business school ‘associate’ roles attest to the superior level of his understanding.

But, reassuringly, he acquired his specialist knowledge after an earlier career as a hands-on manager. Only his frustration at the lack of any intelligent guide to measuring intangibles caused him to divert his course.

“As a manager in various companies – most of them research and development intensive – I found myself frequently fighting with chief financial officers, over the need to fund R&D. They viewed any spending on it as a P&L ‘hit’ without any corresponding increase in the balance sheet,” he says.

Roos’s gut feeling was that investing in R&D and other intangibles was crucial to a business’s growth. However, measuring that value contribution was another matter; he discovered that neither academe nor consultants had the solution.

“So at that point I decided to switch directions, enter academia, and try myself to find a practical way of measuring intangibles.”

In doing so, he approached the issue from both a ‘soft’ sociological standpoint (ie looking at a business’s strategy) and also from the ‘hard’ scientific stance, looking at which tools and methodologies might be adopted and/or adapted from other fields.

Having started his research in the 1980s, Roos can now identify the evolution of IC practices through three separate generations. The first concentrated simply on identifying resources and dealing with them (a balanced scorecard-style approach).

The second concentrated on the transformations of resources as well as their identification (a value drivers-based, IC Index-type practice). The current, third generation, allows the combination of measures of different units into a totality measure reflecting the value perceived by a given observer.

ICS

Roos nowadays delivers his third generation IC ideas not only through academic channels, but also via London-based Intellectual Capital Services Ltd (ICS), through which he and a team of similarly dedicated experts advise companies – profit and non-profit making – around the world. They also act as IC consultants to the consultants.

What ICS does, Roos says, is to work with managements "helping them to rethink their strategies and practices to determine and utilise the intangible drivers for shareholder value growth, and to rigorously evaluate, value and effectively use their intellectual resources to make significant differences".

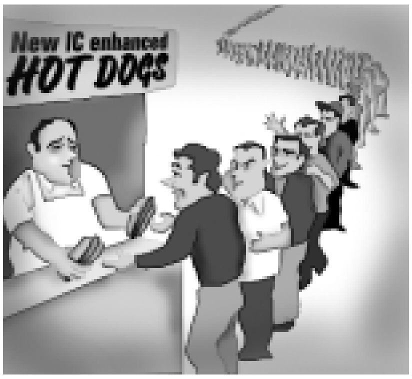
What exactly is the intellectual capital (IC) process?

Roos's definition of intellectual capital is "any resource or transformation under the control of the firm, that contributes to its value creation"; the intellectual capital process is "the science and art dealing with how to extract maximum value from the resources you have and the way you have chosen to deploy them".

This IC process, he elaborates, is about "identifying relevant dimensions along which the strategy of a firm can be discussed. You identify what that firm means when it says it creates value, the resources it considers it must have in order to do so, and the way it deploys those resources. You then compare that with the logical conclusions from the strategy."

This, he says, is classic strategy theory with key success factors and key performance indicators compared and synthesised with a resource based view – in the widest sense – of the firm. It involves understanding how value is created – hence providing the opportunity to improve the potential for value creation as well as the actual value created.

In the process, it is necessary to understand the value drivers within the organisation and – more challengingly – those outside it. The latter category



' ...the hot dog business had quadrupled its market share to 80%... '

includes price, functionality (everything objectively measurable regarding the delivery), distinctness (eg brands), and 'mental proximity' (things that promote person-to-person trust, such as shared beliefs).

One of the exciting outcomes of this analysis is that by aligning key performance indicators extracted from the strategy with those measuring the relevant resource transformations, a tracking system for predicting ability to create value can be devised.

Who can benefit from measuring intangibles – and by how much?

Roos contends that these days most organisations have a significant element of intangibles within their assets, and must at least be aware of, and understand, them. There is, he says, a 'first mover' advantage to a player in a given segment who leads in becoming good at managing its intangibles. And an added bonus is that – unlike with tangibles – margins on intangibles can increase over time.

His checklist for those organisations that can gain advantage from such attention to their intellectual capital includes those in high tech industries, and those with a high dependency on brands, on processes and systems, on relationships, or on individuals' abilities.

Quadrupled market share

The rewards can be enormous, and can be reaped within a fairly short space of time. Take the real case, of the hot dog producer – incidentally, involving not one iota's change to the hot dog sausage itself. ICS segmented the consumer base, and looked at a variety of its value preferences. As a result of the findings, ICS tinkered with some of the value drivers (brand positioning, for one), and the management implemented the recommended changes in a fairly high-powered way, with the result that within 18 months the business had quadrupled its market share to 80%, and has maintained that share for some five years.

What prompts companies to turn to the IC process?

When he began his study of intellectual capital, Roos quickly discovered that the research field could be broken up into four distinct parts. Later, practical experience confirmed his view, with organisations tending to approach ICS concerned about one or more of the following four issues:

1. whether they had the necessary intangible resources to guarantee value creation;
2. how they might best deploy those resources to maximise the value created;
3. how efficiently they were generating this potential value; and
4. how – given that all of the above issues were being successfully negotiated – the value thus being created could be impressed upon stakeholders (value, like beauty, existing chiefly in the eye of the beholder).

The first is an issue about identifying what is necessary to start – or continue – creating value; the second is about the correct use of the required ingredients; and the third is about having the ingredients, and the business model, but needing to track the efficiency of the value creation.

The fourth issue – the familiar problem of convincing the stakeholder of created value – can often involve managers in what Roos calls "a trade-off with the community of shareholders". In this regard, he adds, the business must operate along a continuum of "doing what the shareholders expect while changing their expectations to tally with what the outcome of your strategy will be". At the same time, if the organisation so desires, the IC process can provide the tools with which to value whatever it does, from the perspective of a given stakeholder.

A complex problem

The business of creating value from intangibles with maximum efficiency is, Roos admits, a complex one. He is scathing about what he dubs The Heathrow Library of Management, in other words "books you buy at airports, full of simplistic tools, and not grounded in anything more than a Sunday afternoon's thought".

He describes, instead, two different approaches. First, you can look at how each individual activity can be performed better. Alternatively, you can consider how the system of activities could be improved. He favours a combination of the two, forming 'the IC lens' for determining the value creation path in an organisation.

In his view, "The only way you can analyse the effectiveness and efficiency with which an organisation creates value, is by taking the intellectual capital perspective."

And that perspective involves:

- looking at where the organisation is now, and where it wants to be (the difference forcing it to perform better on its cost drivers and some of its value drivers);
- looking at what types of competence it has, and how it uses them; and
- similarly, investigating its processes, structures, systems, brands and intellectual property and how those are used.

In many ways, Roos claims, this is the key to the business's fitness to meet the unknown challenges of the future.

Conclusion

Increasingly the IC process is being recognised as a 'hard' rather than a 'soft' area of management. In Roos's experience, while IC projects may initially be the province of human resources directors, CFOs soon take charge once the scientific, numbers-based nature of the exercise becomes clear.

The way ahead, he reckons, is either for the IC field to be recognised as a science in its own right or for it to be regarded as a synthesis of sub-sciences (such as finance, systems theory, management theory, strategy and accounting).

If the former happens, IC will require its own recognised standard of language, acknowledged by the academic community. If, on the other hand, it becomes regarded as a synthesis of other sciences, then the need will be for an acceptable practice (eg on how to report on intangibles), agreed by the various practitioners.

Regardless of which path it takes, though, the IC process is rapidly being embraced by those chasing competitive advantage, not least those in the finance function.

Göran Roos will be lecturing on Intellectual Capital on 3 July 2001 – see page 15 for details.

How to measure intangible assets

Dr Caroline Vance, programme director in knowledge management at the Centre for Exploitation of Science and Technology (CEST) describes a CEST team project into how better to understand and manage the valuation of intangibles.

Technological and other developments mean that an increasing proportion of companies' assets are of the 'intangible' kind. This creates tremendous complexity over how such intangibles can be assessed and managed – not least because lack of information about a company's assets can produce share price volatility and difficulty in raising capital.

A collaborative project

The Centre for Exploitation of Science and Technology (CEST) – a not-for-profit organisation which identifies attractive opportunities within science and technology, acting as an interface between interested parties – recently led a collaborative project to bring some understanding and pointers to the complex 'intangibles' issue.

After creating a consortium of parties from the corporate, government and financial worlds, to sponsor and guide the project evolution, CEST set out to explore the current views and practices of both 'valuers' (analysts and fund managers) and 'valuees' (the companies).

A year-long programme of in-depth interviews was carried out with City analysts, fund managers, members of the FD100 group of corporate financial directors and several other senior officers of large UK listed companies.

Companies will drive any change in assessment and communication of intangibles

The assumption underlying the project was that the City and companies value intangible assets differently, creating general frustration. This was not entirely borne out by the findings.

The City respondents, though eager to receive as much information on intangibles as possible, tended to feel that the current levels of information provided were quite healthy. A concern which was voiced was that more detailed reporting on intangibles might be accompanied by corporate 'spin' which would then need to be disentangled from the underlying data.

The corporates, for their part, were not overwhelmingly interested in communicating the value of their intangibles externally, to analysts. Indeed, apart from those with a 'mature' relationship with the City, based on a history of significant disclosure about intangibles (eg the pharmaceuticals) many were nervous that any new metrics adopted might be insufficiently understood, or taken out of context.

The companies' interest is to be able to manage their intangible assets internally as effectively as possible. Recognising the increasing intangibility of the asset base, they were anxious to 'get a handle' on measuring intangibles principally because 'what gets measured gets managed'.
.
Thus the project findings suggest that change in the way intangible assets are communicated will be driven more from the corporate world's desire to manage them well.

The project produced some useful pointers for forming a strategy on communicating intangible value creation effectively. In particular:

1. It is in a company's interest to clarify its communication of the value of its intangible assets.

Both sides of the debate consider the balance sheet as a tool with limited input to the valuation process, electing cash flow as the primary way of understanding the fundamental value of a company.

Yet, despite intangibles providing a growing proportion of the market value attributed to the discounted future cash flow, that proportion is currently communicated in a fairly ad hoc manner. It is in a company's interest to clarify its communication of the value of its intangible assets.

2. New thinking can be introduced subtly through dialogue with 'star' analysts.

The City analysts did not, on the whole, want standardised intangible asset reporting, although they did want more information on intangibles. Their skill is to interpret information and use it to advise investors. Companies, therefore, are advised to 'get it right internally' – to measure contribution to shareholder value of various intangible aspects of the business internally. Also they are advised to 'influence the City via the analyst thought-leaders': rather than springing new measures on the City at reporting time, new thinking can be introduced more subtly through dialogue with 'star' analysts.

3. Serious thought should be given to 'how much' information to release and 'how often'.

Some financial directors are concerned about publicly releasing too much information as it could be used by competitors. Another potential pitfall is that once these details are available, they will need to be updated regularly with good news.

Anyone interested in obtaining the executive summary of the report, or in participating in the further development of the project, should contact Dr Caroline Vance at CEST. Tel: 020 7354 9942; email: cvance@cest.org.uk

Intangibles – a selection of views

● "The creation of megabrands or global brands such as the Teletubbies has a 'rainbow' effect on other brands in our portfolio whereby both the consumer and the retailer anticipate out ability to produce another worldwide success."

David King,
Worldwide BBC

● "One of the reasons I am interested in introducing more intellectual property valuation into company reporting is to try to explain the difference between our balance sheet valuation and the market value. Of course the gap of many billions of pounds to some extent reflects the market's view of our future earnings capability, but it should also essentially be a view of the future value of the work we are putting into R&D. By (our) applying consistent methodology every year investors should be able to follow the trend of our value and the trend of the market value and be able to draw very helpful information about the future of the company."

John Coombe
Glaxo SmithKline

● "Intangibles *are* Cadbury Schweppes. We effectively have two types of brand to offer: the original Cadbury, Schweppes and Fry's, which do not appear on the balance sheet; and the likes of Trebor, Bassett and Dr Pepper – acquired over the last 15 years – which do. It is an odd amalgam and traditional accounting does not deal with it terribly cleverly."

David Kappler
Cadbury Schweppes

● "The value of intangibles cannot be too stressed. Consider (James) Dyson and his patents. Had he not had a patent then his future cash flows are highly unlikely to have come, because some other vacuum maker would have walked up and taken a large slice of his market."

Professor Brian Toft,
Marsh Risk Consulting

● "To the extent that you can quantify input to the intangible based on the R&D, I would be reluctant to see that translated into a figure on the balance sheet because there is so little correlation – or has been historically – between money in and value out in R&D, in any meaningful time frame."

Jo Walton
Lehman Brothers

ANNUAL MEETING
and
REPORT FOR 2000

Notice is hereby given that the eighth Annual Meeting of the Faculty of Finance and Management will be held at **12.30pm** on **Wednesday 13 June 2001** at Chartered Accountants' Hall, Moorgate Place, London EC2, for the following purposes:

1. To receive the annual report and financial statement of the Faculty of Finance and Management, for the year ended 31 December 2000.

2. To receive a report on Committee membership changes from 20 June 2000 to 12 June 2001.

3. To receive a report of the results of the elections to the Faculty Committee in 2001.

4. To answer questions about the activities of the Faculty of Finance and Management.

A workshop will precede the formal proceedings, and a buffet with wine will be available after the AGM to enable members to meet each other and members of the Committee in an informal setting.

CHRISTOPHER D JACKSON
Head of Faculty
Direct Dial 020 7920 8486

Notes: A member of the Faculty is entitled to attend the meeting and, on a poll, vote in person, or may vote by proxy. The instrument appointing to a proxy must be received by the Head of Faculty of the Faculty of Finance and Management at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ by noon on Friday 8 June 2001. A form of proxy may be obtained from Kirsten Fairhurst at the same address. A member who thereby lodges a form of proxy will not be debarred from attending in person and voting, but must inform the Head of Faculty before the meeting of his or her intention to vote in person.

CHAIRMAN'S STATEMENT

Growth

We are proud of having achieved our target of 10,000 members a year early. Our high retention rate tells us that we are providing what members want and that we offer unmatched value for money. We will continue our marketing efforts in 2001: we are convinced there are many more Institute members who need what we have to offer.

Activities

Our publications provide the bedrock of our services. *Management Quarterly*, *Manager Update* and *Good Practice Guideline* are all produced on a quarterly cycle. Our monthly newsletter was renamed *Finance & Management* (previously *Financial Focus*) to better reflect the broad focus of the faculty. *Management Quarterly* remains our most popular publication with its accessible and comprehensive features on marketing, strategy, HR and finance. It was originally scheduled to be complete by mid-2001 but, as a result of its success we are extending it.

Building on previous experience and feedback from members we concentrated our events programme on a smaller number of large events. Three half-day conferences provided the same event to Faculty members regionally. They were all fully booked and we plan to expand our provision of similar conferences in 2001. We will continue the series of London lectures, which will be recorded and made available to all Faculty members.

The internet is becoming increasingly important as a delivery mechanism to members. We have worked hard in 2000 to improve our web site. By December 2000 we were receiving more visits than any other part of the Institute members' site. The site is content-driven and aims to provide answers to members' business problems. All our output is available for download and we have a knowledge search which will eventually identify every article we have written, categorised under 62 topic areas and provide links to other relevant material. In addition we are developing MQ Online and expect shortly to launch the first batch of web-based lectures, loosely based on *Management Quarterly*. We are excited by the high quality of the new programme.

Finances

Our aim is to break even, taking one year with the next, while maintaining two to three months' income in reserves. However the rapid growth in membership at the end of 1999 resulted in a higher than budgeted surplus in 2000. As a result we are well placed to improve existing products and launch new ones.

The Institute

The Institute is continuing to go through a period of change. We are working with the Members' Directorate, The Centre for Business Performance, the other faculties, the focuses and other parts of the Institute to achieve our objectives while supporting their development. In addition we are maintaining existing contacts with like-minded organisations in the UK and overseas.

People

I should like to thank all committee members who have given their time and expertise to make the Faculty the success that it has become. I should also like to thank Chris Jackson, Judith Shackleton, Jacqui Newell, Debbie Came and Maria Carlstrom for their continued enthusiasm and commitment.

The future

2000 was another successful year for the Faculty. Going forward, we will maintain the quality of our output; we will continue to develop our activities; and we will continue to provide value for money. I am confident the Faculty has a great future.

JOHN EDWARDS
March 2001

FINANCIAL STATEMENT

Year ended 31 December 2000

	Note	2000	1999
		£	£
Income			
Faculty subscriptions		585,026	395,479
Notional interest on funds held		27,589	18,748
Miscellaneous income		31,250	23,344
Total Income		643,865	437,571
Expenditure			
Employment costs		142,487	134,091
Publications	1	240,731	156,904
Costs of mailing		118,202	83,879
Marketing and PR		27,063	35,080
Internal recharges	2	91,544	102,138
Events		50,670	41,124
Miscellaneous		18,878	19,491
Defrayment of costs by Institute for Faculty activities which benefit all Institute members		(161,289)	(154,108)
Total expenditure		528,286	418,599
Surplus for the year		115,579	18,972
Surplus brought forward from previous year		152,021	133,049
Surplus carried forward		267,600	152,021

J R Edwards
Chairman
19 March 2001

Notes:
1 - Included in the cost of publications is a payment of £1,825 (1999 £1,625) to Ruth Bender, a co-opted member of the committee, in respect of her work on *Management Quarterly*.
2 - Institute recharges for accommodation, common office services and committee expenses.

ACCOUNTANTS' REPORT TO THE MEMBERS OF THE FINANCE AND MANAGEMENT FACULTY

We have examined the financial information for the year ended 31 December 2000 set out above and tested, on a sample basis, items of income and expenditure shown therein.

This financial information has been properly extracted from the books and records of the Institute of Chartered Accountants in England and Wales, of which we are auditors and on whose financial statements we have issued an unqualified audit opinion on 19 March 2001.

RSM Robson Rhodes
Chartered Accountants and Registered Auditor
19 March 2001

FACULTY COMMITTEE

Executive Committee Members
(at 31 December 2000)

John Edwards
(Chairman) (c)*
Smiths Group Plc

Martin Kimber
(Deputy Chairman)*
Kimbers Practical Business Strategies

Charles Bartholomew
The Post Office

Ruth Bender*
Cranfield School of Management

Lois Bentley
Bridges Financial Management

Anthony Blackstock
Business advisor

Kevin Bounds
KPMG Management Consultants

Mark Garratt
Thurloe Corporate Finance Ltd

Elaine Oddie (c)*
Morrison Stoneham

Paul Edwick
Lucy Lockett Ltd

Douglas Shanks
Levy Gee

Professor Bob Sweeting*
Manchester Metropolitan University

John Tranter
Eaton Williams Group Ltd

Peter Welch*
Various directorships

Colin Whipp
Omnicom Media Services Europe

* Co-opted
(c) Member of Council

REPORT ON ACTIVITIES 2000

Publications

Finance & Management:	12 issues published throughout the year	
Management Quarterly:	Issues 6-9	
Manager Update:	Issues 12-15	
Good Practice Guideline:	Issue 29	21st Century Budgeting
	Issue 30	E-Business
	Issue 31	Product Life Cycle Management
	Issue 32	Making an Acquisition

Events

Conference	*Places*
The role of the balanced scorecard and the threats and opportunities it presents to accountants *Kevin Bounds – KPMG Consulting*	London, Solihull and Huddersfield
Leading edge performance measurement techniques *John McKenzie – Armstrong Laing*	London, Solihull and Huddersfield
The inner business of creativity and innovation *Marion Moriarty & David Smith – Inner Business*	London, Solihull and Huddersfield

Other events	*Place*
Change Management *Marion Moriarty & David Smith – Inner Business*	High Wycombe
Relationship Marketing *Lynette Ryals – Cranfield School of Manangement*	London
Profit Improvement *Linda Frain – Expense Reduction Analyst*	Solihull
E-Business *Carolyn Haworth FD – Reuters Information*	London
Human capital – human performance – human resources – what's happening to people in our organisations today? *Dr Veronica Hope Hailey – Cranfield School of Management*	London
Value Based Management *Matt Davies – ATC CPD Ltd*	London

Faculty membership
Number of members at 31st December 2000 – 10,201
(1999 – 7,144)

International activities
Representation on the International Federation of Accountants Financial & Management Accounting Committee

FACULTY STAFF

(at 31 December 2000)

Chris Jackson – *Head of the Faculty*
Judith Shackleton – *Technical manager*
Jacqui Newell – *Services manager (Maternity leave)*
Maria Carlstrom – *Administrator (Maternity leave)*
Debbie Came – *Administrator*

The second stage – developing a future direction

In this second in a series of articles on strategy, **Chris Hughes-Rees** reviews the strategic steps of situation analysis, segmentation, time horizons and risk analysis.

In the opening article on strategy (*Finance & Management,* issue 71), within the context of initial vision development, I discussed the need for an organisation to look at the likely future shape of the world, its characteristics, its markets, its consumers and so forth. I then established its need to understand fully the shareholder and stakeholder drivers and finally discussed the requirement to be aware of the changing shape of the business growth components by using the application of portfolio analysis.

Following on from that the organisation's next steps must be to establish where it is today and then move on to the initial stages of developing the future strategic direction.

Situation analysis

Before plotting the future, it is essential to have a thorough understanding of the organisation as it is today – how it works, its strengths, its weaknesses, its structure and the surrounding environment.

The temptation is to completely skip this element, in an eagerness to press on with the real stuff of the future – adopting the view that much of the information generated by this step would be discovered by the later stages in the process. But be warned; to do so could lead to even more work and inefficiency resulting from the need to constantly go backwards to understand today's picture. It would be a futile short cut and leave gaps, potentially fatal, in understanding.

Six areas for analysis

Broadly, I see the categories for analysis to achieve this understanding as essentially sixfold: market analysis, competitor analysis, organisation analysis, value chain analysis, cost base analysis and finally a review of the IT platform which these days, of course, captures supply chain and e-business capability. These six areas, together with the work completed in the previous steps, will provide the basis for total understanding of an organisation's business structure, operational capability and the surrounding competitive environment of the day.

I stop short here of suggesting what the business needs to do and look like in the future as this will be driven by later stages in the strategy development. This is perhaps where most patience is required – in restraining the eagerness to start plotting ahead. The outcome of this step is designed to produce a secure platform for developing the future direction and is

FIGURE 1 SITUATION ANALYSIS

Competitor analysis
- Who are they ?
  - SWOT for their position
- Market position
  - USPs ?
  - Organisation culture ?
  - Strategy horizons
- Where are they heading ?
- New competitors emerging ?
  - Who ?
  - Why ?
  - USPs ?
- How do we out-smart them ?
  - First to market & early mover advantage ?
  - Shape or follow ?
  - Better process ?
  - Better strategy ?
  - Better products / services ?
  - Better service ?
  - Better brands ?
  - Better margins & investment returns ?
  - Do we buy out competitors & rationalise ?

SITUATION TODAY

DIRECTION/TRENDS

VALIDATION

&

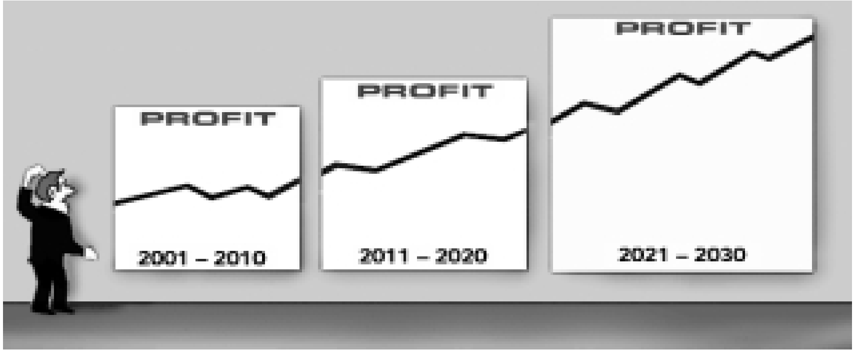
JUSTIFICATION

CHALLENGE

SESSIONS ?

not an element of the plan itself. As is the case with most elements of the strategic process, it is important to apply the appropriate business and analysis tools when undertaking what should be a very robust and possibly lengthy analysis stage.

However, this stage of the process will very likely produce the welcome early bonus of unearthing some immediate business improvement opportunities – subject to developing the later strategy stages of course!



'Vision is typically a long-term view... we must carve it up into a series of logical stages and build up to our end-state vision.'

Strategy segments and time horizons

Getting down to the serious plotting of the organisation's future, it is first necessary to determine what the different strategy segments (or business streams) are. They could, for instance, be product/service clusters, in different markets, in different geographical areas and so on. It is clearly important to have clarity in these segments, understand why they are structured as they are, and be able to defend the reasons as to why the selected segment structure is optimal.

The red flag here relates to any attempt to force the existing structure into the future markets. To do so will have dire consequences. A cornerstone of any strategic effort is flexibility and, therefore, the willingness to re-shape the organisation, perhaps quite dramatically, as all other factors are considered.

Within each segment, the overall goal is to determine what and where the organisation should be at various time horizons in the future and what the components for building this future are. At this point, management begins a balancing act and must give the sequence of its thinking and planning careful consideration. So far, it has run its process through the stages of vision, shareholder requirements, portfolio analysis and then situation analysis. Vision is the high level start point, then situation analysis and future projections are used to outline where the business may go, but it is important to loop back to the portfolio analysis and shareholder requirements at appropriate intervals to ensure that all requirements and expectations are being fulfilled.

Ultimately, the key point to stress is that there has to be a logical balance to the business across all dimensions at all the future time horizons. It must be projected and balanced in terms of risk, markets etc, recognising that all aspects are clearly closely linked.

The outcome of this strategy step is the definition of achievements in terms of growth and results at a number of strategic horizons along the road to the ultimate vision. To do this, we need to plot what we want to do with what products and services, in what markets, against what competitors and with what competitive results. Ultimately, the organisation needs to have a clear goal and view of its competitive position at each horizon, not just at the end point.

But why is it important to plot these time horizons? Quite simply, vision is typically a long-term view. Defining long term is subjective and will be primarily driven by the markets operated in; but whatever its absolute duration, we must carve it up into a series of logical stages or time horizons and progressively build up to our end state vision. This is also necessary (as I will discuss in a later article) when building our implementation plans which need to be broken down into multiple stages.

Risk analysis

At this stage it is crucial to apply the correct level of analysis and risk modelling. By implication, the correct level of sophistication in our selection of risk modelling tools and their application to the strategic direction and goals just developed will enable the risk profile of the strategic intent to be fully understood, both on a component and collective basis. Additionally, full account needs to be taken of the data generated by the situation analysis step.

A simple recommendation... yet the subject of risk can be a hugely complex area often requiring specialist resources and software. The risk (or probability) of an event, or series of events, occurring and the impact must be clearly understood. This effort may lead to changes in the strategic goals.

Remember, the strategic process development up to this point has probably contained many assumptions and – however robust the earlier analysis – it is essential to understand fully the strategic intent from a risk perspective. Risk is undoubtedly an aspect that historically has been neglected or lacked clear and detailed analysis tools. If we do not understand the risk profile of the strategic intent, then we cannot understand or be aware of the likely range of consequences.

Concluding the risk discussion, although there are many businesses with highly complex and sophisticated models – for example those employed in the financial sector – this does not imply that risk analysis generally leads to over-engineering. Every business is different, and the key is to get the right balance and utilise the most appropriate level of software and skills.

The next in this series of articles will deal with gap analysis, critical success factors, implementation plans and business plans.

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FINANCIAL REPORTING
UPDATE

Major and minor changes with FRS 18

In his latest Financial Reporting Update column **David Chopping** of Moore Stephens looks at the changes being introduced by FRS 18 Accounting Policies, which is replacing SSAP 2, after almost 30 years.

SSAP 2 has been around for a long time. Issued in 1971, the standard has been mandatory since the start of 1972. But it will not quite make its 30th birthday, as it is being replaced with FRS 18 Accounting Policies for accounting periods ending on or after 22 June 2001. SSAP 2 has worn well, with its basic principles having underpinned UK accounting for most of its life. Recently, however, standards being issued have been more and more out of line with the SSAP, and it has been clear a replacement is due.

Strangely, perhaps, it is difficult to say whether FRS 18 represents a major or minor change. It represents a major change as some basic concepts familiar to all accountants have been altered. For example 'prudence' and 'consistency' have been downgraded, and 'going concern' substantially redefined. At the same time, it can be seen as a minor change as the number of companies who will have to change their accounts directly as a result of the standard will be small. In this sense, other standards have already paved the way for FRS 18.

A free choice

In terms of accounting policies, FRS 18 makes it clear that companies are not supposed to have a free choice from all those policies not prohibited by law or other standards. Companies should choose the 'most appropriate' policy where there are options. This was implicit, but never explicit, in SSAP 2.

Some of the major changes are in the accounting concepts that lay at the heart of SSAP 2. 'Going concern' remains in FRS 18, but has been redefined. SSAP 2 spoke about there being no intention or necessity to curtail the level of operations. FRS 18 ignores intention. Companies should prepare their financial statements on a going concern basis unless the company is being liquidated, has ceased trading, or has no realistic choice but to cease trading. There are disclosures required where there are significant doubts about a company's ability to continue as a going concern.

Accruals accounting has also been kept, although matching has been removed. The key to accruals is now the recognition of assets and liabilities, using the definitions taken from FRS 5 Reporting the Substance of Transactions. This may make little difference in practice, as most cases where matching might have previously been used as an argument can still be justified in terms of assets and liabilities.

'Prudence' is no longer considered a basic concept. It has not been entirely eliminated: the FRS points out that in conditions of uncertainty more supporting evidence will be required for assets and gains than liabilities and losses. It has been downgraded, and the FRS stresses that where there is no uncertainty there is no need for prudence, and specifically points out that prudence should not be used to understate assets or gains or to overstate liabilities or losses.

'Consistency' has been subsumed within 'comparability'. FRS 18 states that information in financial statements gains greatly in usefulness if it can be compared with similar information about the entity for some other period or point in time, and with similar information about other entities. This can usually be achieved through a combination of consistency and disclosure.

Concepts

'Relevance', 'reliability' and 'understandability' are also introduced as concepts in FRS 18. While this is the first time these have appeared as concepts in the UK they are not new, as they have previously been dealt with in the Statement of Principles.

The standard also carries over the rules on the 'true and fair' override, and introduces some new disclosure requirements in respect of changes in accounting policies and estimation techniques. The final area it deals with is disclosure of compliance with SORPs, but this change does not take place in June.

David Chopping is the technical partner of Moore Stephens, London. He is a member of the technical and practical auditing committee of the Audit and Assurance Faculty.

MARKETING **UPDATE**

A sharper approach to brands in M & A

Marketing writer **Alan Mitchell** looks at the issues involved in making mergers and acquisitions deliver benefits to shareholders – and suggests ways to improve the brand analysis and marketing strategies related to such deals.

Alan Mitchell writes extensively on marketing and finance, and is a former editor of Marketing *magazine.*

It's a commonly quoted statistic – half or more of all mergers and acquisitions fail to deliver improved shareholder value. So not surprisingly, the quest to minimise this failure rate is on.

Here's a suggestion: too often, traditional mainstay justifications for corporate deals – such as gaining critical mass in terms of market share, opening up new geographical markets, rationalising excess capacity, or jointly developing a promising technology or infrastructure – are simply too woolly. Increasingly, real success will come from identifying synergies and opportunities at a much finer grain of detail: enter 'brand-driven' corporate restructuring.

Pioneering

One company pioneering this approach to deal-making is Procter & Gamble. Three recent joint ventures illustrate the theme. The first is a $4 billion link with Coca-Cola to jointly develop and globally market 'good-for-you' beverages like P&G's Sunny Delight and Coke's Minute Maid and Fruitopia, and snacks like P&G's Pringles. The logic behind this marriage is twofold. First, while P&G has enormous strengths selling to huge retailers like Wal-Mart, Royal Ahold, and Carrefour, what really drives the sales of products like these is impulse purchasing: being available 'within an arm's reach of desire'. This is Coca-Cola's distribution forte. On the other hand, within an organisation like Coca-Cola, any new brand – no matter how big its opportunity – always seems like small beer compared to big brother. What's needed is a completely separate organisation where such brands can get the R&D and marketing focus they deserve.

The second venture is reflect.com, a joint venture with Silicon Valley's Institutional Venture Partners. It sells customised beauty products over the internet. P&G boffins have the technical ability to produce zillions of different types of shampoo, skin care creams and so on. But the demands of current methods of going to market – big brands, advertising budgets plus limited retail shelf space – mean they can never turn this know-how into a positive revenue stream. So reflect.com works according to a completely different model. It applies the 80/20 rule to target the relatively small number of consumers whose spend on the category is particularly high; it offers them the added value of products customised to their particular needs (skin colour, type etc); and it charges them accordingly. It also gives P&G the opportunity to build a relationship with these crucial customers outside of retailers' clutches.

The third experiment is the imaginatively titled Project EMM. This time, it's a joint venture with software company Magnifi to market software developed for P&G to coordinate and manage its global marketing campaigns. Making sure every brand manager in every country is up to speed with the latest decisions relating to product designs, advertising strategies, promotional initiatives, and so on, isn't easy. With this venture, P&G hopes to turn a major internal cost into a significant external revenue stream: companies like Philips are jumping at the chance to buy in to this expertise and infrastructure.

Theme

A common theme unites these initiatives: it's often far more sensible to organise companies around brands (ie significant market opportunities) than attempt to shoehorn brands into preset corporate boundaries and organisational structures. P&G's core business is (quite rightly) organised around the needs of its global brands. That's where its core strengths lie. But the very existence of this structure means that some brand opportunities fall between the organisational stools. The new joint ventures, for example, recognise that there are important differences between selling mainly via impulse outlets as opposed to traditional grocery retailers, between customisation and standardisation, and between selling corporate infrastructure such as software versus traditional consumer products.

As pressure to maximise returns intensifies, we can expect more of such brand- and opportunity-driven restructuring: it allows companies to find new win-wins by mixing and matching their various strengths at a much finer grain of detail. However, it also requires absolute clarity about what makes different brands successful. In fact, it puts marketing savvy at the heart of successful deal-making.

FORTHCOMING FACULTY EVENTS – 2001

To attend any Faculty event, please fill out the form which adjoins this page, remove it by tearing along the perforation, and mail it or fax it to Jacquie Lee at the Faculty's address given on the bottom of the form. If you have any queries relating to these or other events please contact Jacquie Lee on 020 8953 0758.

9 May
FULL DAY CONFERENCE
(Cranfield School of Management, Bedfordshire)

THE CRANFIELD 'CHALLENGES OF MANAGEMENT' CONFERENCE – *DR VERONICA HOPE HAILEY, PROFESSOR RICHARD TAFFLER, PROFESSOR CHRIS EDWARDS AND BILL HENNESSEY (all speakers are from Cranfield School of Management).*
The content of the conference will be stimulating and will challenge your established ways of thinking within HR, management and e-business and finance. Topics include: from education to learning – developing managers for an ever changing world; behavioural finance; managing a portfolio of e-initiatives; key issues in management development; and what really matters in linking HR and business performance. Registration 9.00am; lectures 9.30am-3.30pm with breaks for refeshments and lunch.

25 May
HALF DAY CONFERENCE
(Chartered Accountants' Hall, London)

'BEYOND BUDGETING – MATCHING MANAGEMENT TO STRATEGY' CONFERENCE – *ROBIN FRASER OF CAM-I INC, BRUNO THALMANN OF ARTHUR ANDERSEN, AND DAVID BERKELEY OF BULMERS.*
Robin Fraser of CAM-I, who is programme director of the BBRT, will explain alternatives to budgeting. Bruno Thalmann, a senior manager in Arthur Andersen, Switzerland will outline the Beyond Budgeting survey findings. David Berkeley, finance manager at Bulmers, will describe how his company abandoned budgeting for strategy. Registration 9.00am; lectures 9.30am-1.00pm; buffet lunch until 2.00pm.

13 June
HALF DAY WORKSHOP & AGM
(Chartered Accountants' Hall, London)

'POST ACQUISITION IN CONTEXT – DELIVERING ON THE DEAL!' WORKSHOP – MARY MOORE AND IAN SHORTLAND OF BUSINESS LEARNING PARTNERSHIP.
A 1996 survey found that, although European and Asian managers scored highly on pre-bid skills, they scored worst in the planning and execution of the integration. This programme will look at:: an overview of the merger and acquisition process; the consequences of not getting it right; post-acquisition in context; group case study; an example of successful integration; and the questions to ask. The workshop will be followed by the Faculty of Finance's AGM. Registration 9.30am; workshop sessions 10.00am-12.30pm; AGM 12.30pm-12.45pm; buffet lunch 12.45pm-2.00pm. (Places are limited)

3 July
EVENING LECTURE
(Chartered Accountants' Hall, London)

'INTELLECTUAL CAPITAL – THE BASIS FOR SHAREHOLDER VALUE: MEASUREMENT AND VALUATION ISSUES' – GÖRAN ROOS, CHAIRMAN OF INTELLECTUAL CAPITAL SERVICES (ICS) LTD AND VISITING PROFESSOR AT THE HELSINKI SCHOOL OF ECONOMICS AND JOE PEPPARD, SENIOR RESEARCH FELLOW, CRANFIELD SCHOOL OF MANAGEMENT.
The purpose is to familiarise delegates with issues and methodologies relating to intangible resources (or 'intellectual capital') with emphasis on linking strategy, intellectual capital, business logic, cost drivers, value drivers and revenue with market valuation. The main presentation will focus on introducing concepts as methodologies and there will be some case studies. Registration and coffee 5.45pm; lectures with case studies 6.00pm; and buffet and networking 7.30pm to 8.30pm.

12 September
CONFERENCE
(Leeds University Business School)

'E-COMMERCE' – PROFESSOR KEVIN KEASEY, HOLDER OF THE LEEDS PERMANENT BUILDING SOCIETY CHAIR IN FINANCIAL SERVICES, DIRECTOR OF THE INTERNATIONAL INSTITUTE OF BANKING & FINANCIAL SERVICES; AND PROFESSOR NICK WILSON OF LEEDS UNIVERSITY BUSINESS SCHOOL AND DIRECTOR OF THE CREDIT MANAGEMENT RESEARCH CENTRE.
Topics include: the e-commerce space – past, present and future; e-procurement; e-business and e-finance; experimental marketing and its impact on business; valuing internet companies; managing trading relationships; credit management; late payment; and commercial scoring. Registration 9.00am; lectures 9.30am; and buffet lunch 12.30pm to 2.00pm.

18 September
EVENING LECTURE
(Chartered Accountants' Hall, London)

'THE BALANCED SCORECARD' – ROBIN BELLIS-JONES, MANAGING DIRECTOR, BELLIS-JONES, HILL & PRODACAPO LIMITED.
The balanced scorecard has established itself as a definitive management tool of the 21st century enabling the vision of a strategy-focused organisation to become a reality. The lecture will begin with a short introduction, moving on to discuss implementation issues and then concentrating on maintaining momentum and the areas of difficulty commonly encountered. Registration 5.45pm; lecture 6.00pm; buffet and networking 7.00pm.

RECORDINGS OF FACULTY LECTURES

Recordings of the London lectures are available, in both **audio** and **video** format. To obtain a recording, please tick the audio and/or video box on the tear-off response form opposite.
There is a charge of £5.00 for audio recordings and £10.00 for video.

THIS MONTH

DYNAMIC STRATEGY – CREATING SHAREHOLDER VALUE THROUGH STAKEHOLDER MANAGEMENT
Mark Thomas of PA Consulting Group illustrates how companies which adopt this approach obtain superior returns.

Defining the new ‘e’ generation

Stuart Crainer, writer on management issues, argues that, despite the recent slide in dot.com shares and the bursting of the internet bubble, there is a new generation of entrepreneurs at work – and he has written a book about it all.*

This is the era of the entrepreneur. What began in the entrepreneurial melting pot of Silicon Valley as a dream for a select few has become a worldwide phenomenon. For growing numbers of young people, creating a business has become a mission. It is the new zeitgeist.

The new shapers of business are ‘generation entrepreneur’ (gen e). So what are the gen e characteristics?

Energy

Gen e are dynamic, restless creators. High energy levels are vital for entrepreneurial success – a prerequisite for the job.

But maximising entrepreneurial energy is more than running fast or working harder. For gen e, how they enthuse others is more important than the hours they work.

The energy characteristic of gen e leads them to question what others assume. They invent different approaches and try new things.

Essence

The second characteristic of gen e is an ability to focus energy and thinking on the issues, trends and people that really matter. Energy is channelled to the essence of what is important.

The ability to cut out the dross, the distracting stuff, has never been more important. Choice and complexity can overwhelm. No matter what, gen e keep communication as simple as possible.

Electronic

Gen e are wired – no surprise there. When it comes to new technology they get it in a way most big companies can only dream of. Technology is seen by them in an entirely practical light.

Educated

Gen e’s fourth essential ingredient is education. More than ever before, education equals money. (It also equals efficiency: a 1995 study by the National Centre of the Educational Quality of the Workforce looked at 3,100 US workplaces. The research found that an average 10% increase in the workforce’s educational level led to a 8.6% increase in productivity. In contrast, a 10% increase in plant and equipment increased productivity by 3.4%.) In the new economy, it pays to have an education.

Enthusiasm

To top off energy, gen e are natural enthusiasts. For gen e the job matters. They are not the only ones: why else is Jack Welch running GE after a triple-bypass or Michael Eisner at Disney after his heart attack?

Empathy

The sixth important element in gen e DNA is that they value the human dimension; e = empathy. Previous generations just paid lip-service to the idea. Gen e know that people make the difference.

Emotion

Now the going becomes soft. “There is money in emotion. This is not an obscure flaky agenda. If contemporary business was only a case of bits, brains and brands, why does Citibank work with Elton John? Why did Motorola and Microsoft team up with the Rolling Stones? And why did Miller enter an alliance with MC Hammer? The answer is short and melodic: vibes,” observe Kjell Nordström and Jonas Ridderstrålle in their bestselling book, ‘Funky Business’.

* *‘Generation Entrepreneur’ by Stuart Crainer and Des Dearlove is published by ft.com priced £18.*

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