

Table 6.6 Acronyms used in valuation and portfolio management

Acronym	Meaning
DCF	Discounted cash flow
DTA	Decision tree analysis
ECV	Expected commercial value
IRR	Internal rate of return
NPV	Net present value
TBE	Time to break even
BSM	Black, Scholls and Merton

Recommended Reading

- (1) Bernstein, P. L., *Against the Gods: The Remarkable Story of Risk* (New York: John Wiley, 1998). An excellent and readable account of the history and ideas of risk and risk management.
- (2) Boer, F. P., 'Financial Management of R&D', *Research-Technology Management*, vol. 44, no. 4 (July 2002), pp. 23–34. Good survey of the available methods for valuing innovation projects.
- (3) Cooper, R. G., Edgett, S. J. and Kleinschmidt, E. J., *Portfolio Management for New Projects*, 2nd edn (Cambridge, Mass.: Perseus Books, 2001). A complete and authoritative review of portfolio management practices, based on extensive research.

Main Case Study **Britannia Building Society – building and evolving a portfolio management process**

Before reading this case study, consider the following generic innovation management issues:

- ▶ What difficulties face a company trying to create an innovative culture?
- ▶ Can innovation be imported into an organization from outside or must it grow from within?
- ▶ How does innovation management differ in service and manufacturing enterprises?
- ▶ What criteria are appropriate for evaluating projects in the service sector?

The Britannia is a building society (the British equivalent of a Mutual Fund), founded in 1856 in Staffordshire in the north of England. It provides mortgages, loans, related insurances, savings and investment products. The Society's key values of reliability, accessibility and personal service served it well, and for much of its life innovation was not high on the Society's agenda.

Main Case Study *continued***The 'Skunk Works'**

The arrival of the internet in the 1990s caused a shift in Britannia's attitude to innovation, and in 2000 a special task force, the 'E-Business Unit', was set up to explore the opportunities and threats it posed, and to promote higher levels of innovation in general. Within this team a sub-group, called 'The Incubator' was given the task of generating new product possibilities and pushing them forward. The team operated as a 'skunk works', in a separate location, away from the day-to-day running of the business. The E-Business Unit was headed by Tim Franklin, who reported directly to the then Group Chief Executive, Graham Stow.

Mark Chizlett, the programme coordinator, approved of this organization: 'Skunk works teams are focused, fast and open to innovation. In a very disciplined, data-rational company like ours we needed a team with some independence and the ability to experiment with running new products; and with a real sense that it is OK to fail.' The Incubator team worked closely with the Board, initially in a three-month intensive strategy review, and later by regular meetings every three months to review projects and manage the portfolio.

From the start the team used a process with four gates to ensure that good ideas were selected and that the balance of projects was appropriate:

Gate 1: Presentation of ideas and decision on which to take forward

Gate 2: Review of solutions and decision whether to do a controlled pilot, 'launch and learn'

Gate 3: Decision whether to proceed to a scale implementation

Gate 4: Review of experience and decision to 'plant out' or sell off.

Review meetings started with a presentation of the existing portfolio and ended with a review of how it stood after the decisions just made. Projects that had reached a milestone were assessed and rated against a 'balanced scorecard' of criteria before being approved to move on. The criteria were different at each gate, being initially rather subjective but getting steadily more rational as the projects matured. Detailed financial analysis was not used, at least in the early phases. It was a learning experience for everyone. Chizlett says the Board were not always in their comfort zone: 'They were used to carefully-documented proposals full of data that had already been reviewed by other committees. But, with appropriate stakeholder management by Tim, they came to find the different approach refreshing and thought-provoking. And it worked: we completed six quite major new projects in the first two years'.

Britannia were well-aware of the deficiencies of running innovation teams outside the mainstream business. Chizlett commented: 'A skunk works is insulated from the day-to-day business and that means it can lose touch with the business case'. So a team of directors oversaw the activities of the

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Incubator, ensuring that it focused on business results and that it had support for the new initiatives. A policy of short-term secondments to the Incubator meant that their new ideas had ready-made champions throughout the business.

One of the objectives the board gave the Incubator was to be torch-bearers for a new culture for the Society. Chizlett thinks that was probably a mistake: 'It was just too much of a cross to bear for the individuals in the team: to set up a new process and new products and change the Society's culture as well. Culture must be generated from within, not by a guerrilla group sniping from outside'.

Innovation Moves into the Main Stream

By early 2003, it was time to devolve the E-Business team. As Mark Chizlett put it 'We realized the internet is no longer something new; it's something that needs to be put back in the business. Anyway, by this time most of the team were implementing the new products and running the internet as a channel'.

But Chizlett was worried about who would now be the 'conscience for innovation': who would search actively for new opportunities? Making NPD part of the value chain rather than a separate function promised to give a clearer route to implementation; and it was felt that the new product ideas would benefit from the insights of people further upstream, who were in regular contact with customers. An NPD mission statement expressed the need very clearly:

'If we don't respond quickly to new products from the competition our members (customers) and prospective members will take their business to those that do, limiting our ability to meet targets and strategic ambitions.'

Britannia would be a fast follower in innovation, a stance driven by both their brand values and resources.

The arrival of a new Group Chief Executive, Neville Richardson, in 2003 provided a trigger for a more concerted move to change the culture of the society and to embed NPD activities more directly in the fabric of the organization. The 'Living the Values' culture-change programme was headed and driven by Richardson. All staff attended a briefing and a road-show followed by intensive training sessions, and company publications and reinforced by new personal objectives. The new culture generated several new sources of ideas: all managers now have continuous improvement goals in their objectives; the suggestions scheme was revitalized; and a route was created from the customer-care department to NPD to feed in opportunities raised by customers.

The position of New Product Development as an integral part of the company was formalized in a new management process, launched in 2003.

Main Case Study *continued*Figure 6.15 **Britannia's project scoring system**

<i>Element</i>	<i>Weight</i>	<i>Manager responsible for scoring</i>
Benefits	4	Marketing <i>and</i> Finance
Customer need	3	Customer Excellence
Strategic fit	3	Marketing
Business risk	4	Product Management
Systems and processes	3	Information Services
Operational complexity	3	Operations <i>and</i> Sales
Delivery cost	4	Finance
Dependencies	3	Information Services
Priority	3	Managing Director

The NPD manager has the job of collecting propositions and ideas from throughout the company and selecting the most promising ones. A committee, with representatives from Marketing, Treasury, IT, Administration, Finance and Sales channels helps with the selection. The managing board, chaired by Tim Franklin, now the Managing Director of the Member Business and a main board Director, reviews the chosen ideas using a balanced scorecard of nine elements, illustrated in Figure 6.15. Individual members of the board themselves provide the scores for the projects, ensuring a high level of consistency from project to project.

'I don't say that what we've done would be right for everyone but it's right for us, here and now', says Chizlett, now promoted to manage the Savings and Investments division, 'There will still be conflicts, compromises, choices. We'll start some things and have to stop and try again. But the conditions for success are all well in train.'