Dealers in high risk and high returns, venture capital investors are keen to monitor the performance of the growth companies they support. CHRISTOPHER GOLIS explains a tested method of assessing how well a new company uses its resources and predicting its likelihood of success.

It was once believed that if you could align a few parts of a company – engineering and marketing, for example – or if you simply produced an effective business plan, you could successfully bring a product to market. But in today’s competitive environment, the successful venture must balance the allocation of resources among many dimensions and do so in a systematic and effective way. This calls for a method to quantify how well an organisation is achieving this balance over its key dimensions.

Investors are of course interested in a company’s current and prospective performance. However, a stronger focus on fiduciary responsibility and an increasingly litigious environment means that more people are looking for systematic, thorough, and quick methods of analysing companies. Among those seeking such a technique are prospective non-executive directors, underwriters, accountants and incumbent managers.

The Bell-Mason Diagnostic (BMD) was the work of Gordon Bell and Heidi Mason, who were co-workers at Digital Equipment Corporation (DEC). Bell was the second computer engineer hired by DEC and is well known as the architect of the company’s VAX product line.

Bell further said that DEC, then a $US500 million turnover company, had the same problem of incompatible products. He proposed that the company should scrap its current development work and focus its efforts on a single computer range that would become the leader in networking.

The change took two years and much discussion but it was done. The result was the VAX line, which carried DEC to $10 billion annual revenues in the 1980s. Bell became famous: he is president Clinton’s personal adviser on the “information superhighway” and was recently recruited by Bill Gates as head of the Microsoft Brains Trust.

Heidi Mason became the head of strategic marketing at Regis McKenna, the leading marketing consultancy in Silicon Valley, and spent a number of years plotting the marketing strategies of such growth companies as Intel, Apple and Sun.

Bell and Mason spent 15 years (1976-91) analysing more than 600 companies and perfecting a rules-based diagnostic approach. They found that their model for successful business development could measure a venture’s progress and predict its likely outcome on the basis of actions completed. One sector they studied intensively was the work-station industry: During the 1980s, US venture capitalists funded 94 work-station companies, of which six captured 90% of the market. Bell and Mason asked: “Why?” and came up with the answer.

WHAT IS THE DIAGNOSTIC?

Their Bell-Mason Diagnostic is a tool for assessing the health of a growth enterprise at four well-defined stages of development.
SOUND OF SUCCESS?

During the third stage an engineering team designs, builds and field-tests the product. The development of marketing programs starts.

Market Development – Deployment

In the fourth stage, volume sales occur. The team is a mature, highly productive unit aiming to achieve six quarters of steadily increasing profits.

The process can be applied to service or resource companies, or to business or product centres within a larger organisation.

At each stage the Bell-Mason Diagnostic produces an easy-to-understand yet unique graph. The four stages are mapped in Figure 2. For example, at the concept stage the BMD shows a successful project needs five key items: a defensible technology, a draft business plan, a chief executive officer, a suitable financing strategy and sufficient cash to get to the next stage. Seven other vectors come into play to some degree at the seed stage, but without the first five factors at the concept stage, success will not happen. How true this is. There are many inventors but few individuals capable of building a business.

Practised investors and entrepreneurs, asked what is the key to business success, will generally answer with a set of rules-of-thumb such as:

“Cash is king.”

“I look for the vision above all else.”

“People, product, plan.”

“A big wave carries a lot of surfboards.”

The Bell-Mason Diagnostic is different in that it provides a systematic, graphical evaluation of a venture, testing 12 factors:

- technology;
- product;
- manufacturing;
- business plan;
- marketing;
- sales;
- chief executive;
- team;
- board;
- cash;
- financeability; and
- control/operations.

HOW DOES IT WORK?

The Bell-Mason approach codifies business and project evaluations by applying rules and guidelines for each of the 12 core dimensions. From that database it has generated a list of rules relating to successful company operations, and from that analysis devised a pool of more than 1,000 questions which require yes or no answers.

Those operating the BMD first carry out a one-hour interview with the company’s chief executive to establish the
stage which the company or product being evaluated has reached.

They then select appropriate questions from the pool and put them to key executives in a structured group interview which lasts for four or five hours. Examples of the BMD questions that are asked about the board of directors of a company at the four stages of development are given in the accompanying box. The answers are then tabulated and the results analysed by the Bell-Mason diagnostic computer program, producing the unique BMD graphs. The BMD analysts finally prepare an 80-page report over two to three working days and present it to the CEO or other appropriate executives. The total executive time taken by the BMD process is about eight hours for the CEO and four or five hours for the other key executives.

WHO USES THE BMD AND WHY?
The uses of the BMD include:
- the first stage of business and strategic planning;
- investment appraisal;
- screening by government grant-giving bodies;
- fundraising preparation;
- development transition;
- redeveloping business strategies;
- due diligence for public listing, sale or divestment;
- due diligence by prospective non-executive directors.

The method has gained widespread acceptance in the past five years among overseas investors, multinationals, corporate advisers and government bodies. Among users are such well-known names as Philips, Motorola, Mitsubishi, Coopers & Lybrand, the Canadian Government Business Development Board and the Scottish Enterprise Board.

WHAT HAVE BEEN THE RESULTS?
Mitsubishi provides a case study of how effective the BMD can be. In the mid-1980s the company lost a total of $US500 million in Silicon Valley investments and joint ventures. Since introducing the BMD, Mitsubishi has not lost a dollar in capital and has had a number of successes (defined in the US as a return of something like five times invested capital in three years or ten times capital in five years).

My colleagues and I have so far completed diagnostics for eight Australian companies. The eight were from a wide range of industries and were all at differing stages of development. One of the six was at seed stage with no current revenue; the other seven were well established companies with a life of at least four years and annual turnover of between $4 million and $45 million. They were profitable, employing between 30 and 200 people and seeking to grow substantially over the next few years. Industries included plastics manufacturing, lighting manufacturing, high-technology electronics, data communication, multimedia and software.

Each of the companies was enthusiastic about the speed, accuracy, objectivity and comprehensive nature of the BMD process and its concise recommendations. They are now implementing the recommendations and have a greater understanding of the dynamics of their businesses and the optimal growth paths.

The trouble with due diligence in most investments is that as you get to know the company you lose objectivity. Also, due diligence tends to start in the two or three best-known areas. We see a major benefit of the BMD in replacing subjectivity in two or three dimensions with objectivity across 12.

The snapshot that the BMD provides is useful not only to prospective directors but also tells the CEO and the management team how they and their company compare with others. The BMD thus provides a good indication of best practice and makes useful, practical recommendations on the next steps to take.

SAMPLE BELL-MASON DIAGNOSTIC QUESTIONS

Concept stage
Have the board members with expertise in the key strategic areas in the business plan been identified for seed and later stages? (Initially the board is likely to be the founders and one or two seed investors. It is unnecessary to have a board before incorporation.)

Seed stage
Does the board have appropriate operational experience related to product and market development in addition to investor representatives?

Product development stage
Has the board been active in helping to recruit key people, attract strategic partners and key customers?
Has the board actively contributed, as reviewers and critics, to the refinement of product, market models, forecasts and plans?

Market development stage
Has the board regularly met once a month to actively monitor and assess the company's real progress against the plan?
Is there at least one board member with marketing and sales experience in the company's targeted segments and selected channels of distribution?