with cash-at-harvest. In other words, to discover her time preference, or personal discount rate. What would Chris do?

I beg Chris not to cop out and say 'these are hypothetical situations, in real life things would be different'. We are trying to agree on the basic principles, in order to determine where quantification and DCF analysis should stop, and where subjectivity should start.

Piers MacLaren

Chris Perley replies

The Parable of Accountant X

In the article to which Piers refers, I didn't argue for the inclusion of uncertainty in decision making as some fashionable, subjective 'tack-on': I argued for its acceptance as a reality. What is more, I argued that relying solely on quantitative data has only the appearance of rational objectivity. The cost and return assumptions involved in any financial analysis have a large element of subjectivity, and can lead you down the garden path, perhaps minimising your return, or losing it all.

As to Piers' examples, he obviously wants me to provide some quantitative analysis. I accept the benefit of quantitative analysis, but only when placed within a broader framework. Given Piers' narrowly defined bounds of consideration (his framework) I must concur with Piers approach. If Mr Alpha and Ms Beta wants the numbers, or rather the perception of an 'objective' comparison of options, then so be it — bring out the spreadsheet, load it with assumptions and feel the glow of certainty and security in the knowledge of our 'rational objectivity'. Our butts are covered and no one can blame us when the projected loser perhaps turns out to be the actual winner.

But does this prove I have overstated the case for accepting uncertainty or the openly subjective and strategic? I think not. Piers has precluded, by his own definition in the examples, the parts of the analysis that, dare I say it, separate the better consultant from the rest — his judgment, her consideration of the uncertainty and the wider qualitative world that exists as a reality.

To illustrate, I'll tell a parable. I am fond of recounting the story of a hypothetical accountant X advising a prospective kiwifruit grower. The 'rational', 'objective', quantitatively derived advice the accountant gave his client in 1968, before kiwifruit was a commercial success, and while land prices remain cheap, was — "Don't invest!" Unfortunately - for the client who had just the piece of land — a bad call.

By 1978 kiwifruit was going hell for leather (unfortunately not for the client, who on the advice of Accountant X sold his kiwifruit land for three marbles and invested in the hot 1968 investment - wringer washing machines). People were leaving their ostriches (or whatever was the last fad) in droves to invest in 'fuzzy green gold'. The client goes back to ask for the 'rational wisdom' of the quantitatively objective, chartered accountant seer (past bad advice being forgotten). The seer crunches his numbers again and says — "Invest!" Wrong again.

We all know what happened to kiwifruit in the 1970s and 1980s — an undersupply on surging demand increased prices, leading to an over-reaction, leading to financial collapse. The same dynamic happened with blackcurrants as well as worldwide, greenfields MDF plants as I recall. Perhaps that dynamic - the tendency to overreact based on the current and historic quantitative data, and its consequences — is also relevant with short and long term forestry investment advice? Six months ago, the numbers might have said sell your forest invest and reinvest in interest deposits, or a year ago to invest in forestry stocks.

How is it that such apparently rational and objective advice from Mr X, the most rational of advisers, could produce the wrong answer — twice? The advice obviously did not include all the information — it never can. But a broader perspective might have made things a little more profitable — a perspective that included what others were or were not doing for instance.

Contrary to Piers' cheeky suggestion that I am perhaps anti-profit, I am interested in my client achieving an actual rate of return rather than a hypothetical one worth only as much as the paper it is written on. I would base my advice to Mr Alpha on a broader understanding first of my client's objectives, resources and especially the key constraint(s) (Peter Drucker advised to always maximise your returns to the limiting factor — be it land, capital, expertise, a lack of liquidity, payback period, whatever). He might, perhaps, own the only local integrated processing plant. Cop out or not, nothing is ever as clear cut and simplistic as Piers would suggest.

The second consideration would be what is going on in the real world: who's doing what; where are we on the business cycle; how much timber, of what quality, by what ownership is coming on stream in three years time; what are the issues relating to managing and marketing timber such as Mr Alpha's; how the forest he owns perhaps complements his other investments; what options it provides in an uncertain world — all the boring, largely unquantifiable stuff that impacts on someone's chosen strategy. I am a firm believer that strategy comes before financial analysis, and financial analysis is an exceptionally poor tool with which to derive such a strategy. Determining a strategy is not just a matter of finding out those factors that relate to the financial analysis — Ms Beta's time preference for instance — it is far more than that.

Setting aside any disagreement I might have with Piers regarding forestry's risks relative to interest deposits and other investments, I wouldn't necessarily bother with the third consideration — quantitative stand and financial analysis (I hear gasps and cries of "heretic!", "unscientific!", "unprofessional!"). The recommendation might fall out of the strategic analysis, without any need for the quantitative. The initial, largely qualitative analysis may, for instance, indicate that his best strategy is to leave forestry well alone. The ironic thing is that financial analysis, devoid of the broader considerations, might indicate the opposite!

The essential consultancy framework I would recommend is therefore — first, understand the client as well as possible (largely subjective and qualitative), then the external environment (involving quantities, qualities and subjectivity). Combine them to identify some form of strategy, including the value of options. Only after that consider the financial quantitative data within that strategic framework — and don't forget its subjective element. So many of us ignore the first two in our haste to claim and strut our 'professional' 'rational', 'objective', 'scientific' mantle. It has become almost a religion.

As the example of the 'rational', 'objective' kiwifruit beancounter should show — any focus on purely the quantifiable is a load of old cobblers. Suggesting a broader perspective does not indicate some personal propensity for floral-decorated VW combies and 'make love, not profit' New Age ideals. On the contrary, the ideology I think doomed to return poor dividends is the pursuit of, and giving sole credence to the quantitative, while ignoring the openly subjective and strategic. McIntosh Ellis practiced the strategic approach. As with the kiwifruit industry, relying only upon the quantitative 'facts' of the day to determine 'rational' actions would have precluded the establishment of our own plantation forestry industry.

So which approach deserves the cloud cuckoo land epithet?

Chris Perley