

DIAMOND FINANCE

the financial & accounting newsletter for the diamond industry

Volume 2 Issue no. 3 July 2008

www.diamondfinance.info

Jeremy writes Credit where credit is due



Contemporary reading of the financial press is giving all in our industry cause for concern.

The credit crisis started about a year ago when the sub-prime mortgage market in the US went severely south. The hedge funds of some of the most prestigious investment banks had to be written down or written off completely. Bear Sterns almost disappeared.

The International Monetary Fund estimated that \$245bn was the direct cost of the credit crunch and that the real cost could be as high as \$970bn. This does not help a weak dollar, which is causing distress to the industry, which has to pay wages in strengthening local currencies.

Almost one trillion dollars of wealth is in the process of disappearing, which means that there will be one trillion dollars less to spend on essentials, and luxury items like diamonds.

However, "every cloud has a silver lining" (see Quote of the Month on page 6) and the bad news augurs well for the well focused company.

Firstly, dollar interest rates have come down dramatically over the last year. Companies which funded bloated memo programs during low interest rates of 2002 to 2005, or developed SoC inspired branding programs had a tough time proving profitability when effective interest rates jumped to around 8% in 2006.

As the graph below indicates, the current low in dollar interest rates is potentially a gift that diamond companies could use wisely. Of course, jumping to give extended memo programs in the US is precisely the wrong step to take under the current circumstances. However, with prices for natural resources booming there are plenty of economies that are awash with cash; some seriously underdeveloped in terms of luxury goods. So, if you have the financial capabilities, go to where the money is.



Another bi-polar like symptom is inflation, which is on the rise in most western economies. This usually creates demand for non-cash investments such as gold, deemed to have an inherent value unaffected by currency purchasing power.

Prices of very large high quality diamonds have shown dramatic increases over the last 18 months, proving that much cash is still available and that diamonds are viewed as a unique combination of luxury spending and long term investment. This trend is an opportunity for the industry, one which does not require sophisticated branding to exploit.

You may need more cash to finance this, if you can obtain it in today's market. ■

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technical corner

Willing it to be good

Goodwill part II

Recognition and measurement of goodwill.

Goodwill is recognised by the acquirer as an asset from the acquisition date and is initially measured as the excess of the cost of the business combination over the acquirer's share of the net fair values of the acquiree's identifiable assets, liabilities and contingent liabilities.

No amortisation of goodwill. IFRS 3 prohibits the amortisation of goodwill. Instead goodwill must be tested for impairment at least annually in accordance with IAS 36 Impairment of Assets.

Negative goodwill. If the acquirer's interest in the net fair value of the acquired identifiable net assets exceeds the cost of the business combination, that excess (sometimes referred to as negative goodwill) must be recognised immediately in the income statement as a gain. Before concluding that "negative goodwill" has arisen, however, IFRS 3 requires that the acquirer reassess the identification and measurement of the acquiree's identifiable assets, liabilities, and contingent liabilities and the measurement of the cost of the combination.

Disclosure

For each business combination (or in the aggregate for immaterial combinations), required disclosures by the acquirer include:

- Names and descriptions of the combining entities or businesses.
- Acquisition date.
- Percentage of voting equity instruments acquired.
- Cost of the combination (with separate disclosure of the number and fair values of equity instruments issued and how fair values were determined)
- Amounts recognised at the acquisition date for each class of the acquiree's assets, liabilities, and contingent liabilities, and, unless impracticable, the carrying amounts of each of those classes, determined in accordance with IFRSs, immediately before the combination.
- Amount of any negative goodwill recognised in profit or loss
- Details about the factors that contributed to recognition of goodwill
- Amount of the acquiree's profit or loss since the acquisition date included in the acquirer's profit or loss for the period, unless impracticable.

Significant Changes in IFRS 3	
Method of Accounting	Must use purchase method. Uniting of interests prohibited.
Assets and Liabilities Acquired	All identifiable assets, liabilities, and contingent liabilities acquired are measured at 100% of fair values.
Goodwill	Not amortised, but tested for impairment annually.
Negative Goodwill	Recognised in profit and loss immediately.
Restructuring Costs	Only recognised to the extent that a liability exists at acquisition date.

The following must also be disclosed unless impracticable:

- Revenue of the combined entity for the period as though the acquisition date for all business combinations effected during the period had been the beginning of that period.
- Profit or loss of the combined entity for the period as though the acquisition date for all business combinations effected during the period had been the beginning of the period.

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SoCrates

Exhibito Ergo Sum

April saw the opening of a new diamond exhibition in Antwerp entitled Diamond Divas. The Antwerp World Diamond Centre - AWDC - invested a lot of effort in presenting a display of fabulous pieces of diamond jewellery worn by royalty, nobility, stars and very rich women.

The jewellery has been presented with the history of the pieces in a clear and informative setting and the €12.50 entrance fee was well justified, although as a journalist I personally got a free peak.

I would have preferred Grace Kelly or Sophia Loren to have featured as the 'face' of the show rather than the less identifiable Swanson wearing a spaghetti hat. But most of my clients prefer me to keep my assessments of intangible assets to the confines of IAS 38.

At the opening gala evening the Minister-President of Flanders made the astute observation that until a few hundred years ago, diamonds were worn by men, as symbols of status and power. Ironically, this representation of men's power has been transformed and converted into a symbol of love for women. *Sic Transit Gloria Mundi*. Thus passes the glory of the world.

I asked various personalities at the AWDC what the thinking is behind the exhibition and what they hope to achieve by presenting it? One of the recurring answers was that the diamond sector has a negative image in the Belgian psyche, and high profile exhibitions like Diamond Divas helps to improve the trade's image.

The recurrent and high profile police action in and around Hoveniersstraat has been prominently covered in the local media, creating a negative, and indeed false, impression of what is a relatively clean sector, certainly compared to industries like oil and precious metals.

Others commented that with the Belgian diamond industry depressed, a glamorous exhibition harking back to the glamorous heyday of diamond jewellery, would evoke a more optimistic atmosphere in Prozac popping Antwerp.

I find myself wondering; Is this really what the AWDC should be investing its limited time and money on at a time of crisis for Antwerp?

The writing is clearly on the wall for the diamond industry in Antwerp. Office space in Ramat-Gan is going up due to rising demand from Belgian diamantaires. More rough is going to stay in Africa. Alrosa is pruning its sightholders list. An air of uncertainty hangs over ABN AMRO since its takeover. Dubai is offering such attractive propositions that even some Jewish diamantaires have moved there. New cheaper and more efficient diamond grading laboratories are coming into play. Traders in Antwerp are discovering that the police can impound your inventory from one second to the next. And the list goes on...

The answer is a qualified yes. Flagship shows which travel around the world are good for Antwerp's image with the general public, something that overflows into the morale of Antwerp's diamond bourses. This can be an important element of a wide ranging overhaul of Antwerp's diamond trading environment. But much more needs to be done to restore Antwerp's pre-eminence in diamonds, or else in a few years time we will be queuing up to see the next exhibition, "The end of 650 years of diamonds in Antwerp." ■

Letter from America

Judah Gutwein

High Price of Gold Can Make Your Mouth Worth Much Money!



The Associated Press reports that people are digging through drawers for old dental caps, fillings and bridgework they saved years ago and selling them at prices that would make the tooth fairy blush.

Instead of hanging on to the pieces as souvenirs, many are turning them over to pawnbrokers, coin shops and specialized firms that buy "dental gold," hoping to take a bite out of the metal's historic run to \$1,000 an ounce.

"People are really cashing in. If a dentist passes away, their kids come in with a big pile of good teeth," said Scott Taber, owner of Taber Coins, a Shrewsbury, Mass., coin dealer that buys dental gold and then resells it to a gold smelter!

He said he used to see only a few customers a month selling gold teeth but now gets that many each week. "People are digging up the gold and starting to sell it," he said. A gold crown typically uses about one-tenth of an ounce of 16-karat gold, which would fetch around \$40 to \$50 at today's prices, Taber said. Heavier pieces of dental gold can command prices of several hundred dollars, he said.

That deal sounds pretty good to people like Ann Davis, a 63-year-old retiree in Rock Island, Ill., who had gold caps and a bridge removed nearly 40 years ago and has held on to them ever since.

"You don't want to throw it away because it might be worth something," she said. "Now that gold's going up it's time to think about selling." →

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Gold prices have been surging since late last year as the weak dollar, record crude-oil prices and fears of a U.S. recession have enhanced its appeal as a haven for investors. Gold set a record of \$1,038.60 an ounce on March 17 and has since fallen to about \$920, but experts say it could soon resume its upward climb. Several precious metals analysts have even predicted \$2,000 gold ahead as a global commodities boom pushes the price of raw materials further into record territory.

Gold crowns, fillings and bridgework are usually made of 16-karat gold, an alloy that contains other metals such as silver, zinc and copper. That made gold dental work soft enough to shape but hard enough to form a biting surface. But don't expect to get rich hawking gold fillings and crowns. And replacing a gold crown isn't cheap. Newer porcelain and gold crowns can cost \$500 to \$3,000 apiece, and not all insurance companies will pay for the procedure.

Besides the financial benefit, Taber says people don't mind selling dental gold because it's far less emotional than parting with heirlooms like grandma's wedding ring or the family silverware. "I haven't seen anybody with sentimental teeth," Taber said. Smile! You may be chomping on big money!

jurisdictions Mauritius

In the previous issue of Diamond Finance, we looked at the basics of the two Mauritius companies, Global Business Companies (GBC) 1 and 2. In this article we look at GBC1s and GBC2s in more detail.

A GBC1 (old Offshore Company) pays corporate income tax at 15% GBC1 Companies are also exempt from stamp duty, land transfer tax, and capital gains tax. The expatriate staff of offshore companies pay half the normal rate of personal income tax; two of them per company can import cars and household equipment free of customs duty.

There are no withholding taxes or equivalent deductions on dividends or other payments made by GBC1 companies to non-resident shareholders (residents aren't normally allowed to hold the shares of such companies).

GBC1 Companies are regarded as being resident, and are therefore able to take advantage of Mauritian Double Tax Treaties. The tax treaty with India is particularly favourable, and Mauritius is a favoured location for holding companies for those trading with or investing in India.

GBC1 Companies can also utilise the unilateral foreign tax credit which is 80% of the Mauritian tax rate (leaving a residual liability of 20% of the Mauritian tax rate = 3%); the credit used to be at the rate of 90% and it is possible that there will be further reductions.

Offshore Banking Units, Captive Insurers and Offshore Investment Funds, all of which have the GBC1 Company as

their basis, are taxed as for GBC1 Companies in general.

A GBC2 (old International Company), - officially an exempt-status GBC1 Company - has the same tax benefits as a GBC1 Company; however, it is considered as non-resident, and cannot make use of Mauritian Double Tax Treaties.

There are also Mauritius limited life companies, limited partnerships, sole proprietorships and trusts, but these are less useful in tax planning for diamond and jewellery companies.

Double Taxation Treaties

Mauritius has signed double taxation treaties with a lot of diamond mining, manufacturing and trading countries such as Botswana, China, India, Namibia, South Africa, Thailand and the United Kingdom. Mauritius is currently awaiting ratification of its double taxation treaties with Belgium, Lesotho, Mozambique and Russia. It does not have any treaties with Israel, UAE and the USA.

In the next article, we shall look at the use of Mauritian companies in the international tax structures of diamond and jewellery companies. ■

marketing view The Mark of Cain



by **Tulli Padwa**

director:
Iceberg Advertising bvba
Antwerp

www.
icebergadvertising.com

The launch of the De Beers Forevermark as a consumer trademark, slipped by remarkably unremarked within the industry. Notwithstanding the devastating effects the most fundamental change to the De Beers marketing strategy in the past half century could signal to the selling power of those not within the syndicate's orbit.

Already, a glance at the De Beers literature shows a new and highly exclusive language developing. On the Forevermark website I notice that Pluczenik are offering for sale a matching pair of 26 carat brilliant cut stones. They are described as the "largest matching pair of brilliant cut Forevermark diamonds in the world", insinuating that diamonds branded in this way are in some fundamental way different from all others. What should be more worrying, to those not plugged in to the DTC marketing machine, is the implication that all non-Forevermarked diamonds are somehow inferior for being unbranded.

The use of exclusive branding techniques to sell diamonds is not only desirable in the current market but inevitable. As the supply market fractures into more and smaller pieces, each supplier is going to feel forced to find ways of differentiating his product. ➔

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The Forevermark as we now see it, is indeed a top rate branding, completely unlike the artificially nurtured non-brands that so spectacularly misfired following the introduction of the DTC's SOC program four years ago. Even within the marketing community, where much criticism was levelled at the mark following its B2B launch, a grudging respect is beginning to emerge as details of the new consumer brand emerge.

The surprise announcement last year that even non-sightholders, and stones supplied by other producers, would be eligible for branding, despite the understanding from the beginning that Forevermark would distinguish sightholders from the riff-raff, is clear confirmation that much more lies behind this innocuous mark than at first meets the eye.

Indeed this mark, supported and promoted by the sightholders for years now, might not, in the end, serve to encourage and promote new demand for the sightholders benefit, as they fondly cared to believe up till now. Nor is it really needed to boost consumer confidence. I have seen no significant research indicating that diamond consumers are massively bothered by the moral implications of buying diamonds, before the issue is forced onto them by those manipulating the media for their own nefarious ends. However, Forevermark, if it is a success, will consolidate De Beers' own market share downstream, and it could well help shore up its dominance of the marketplace even as its market-supply share wanes.

True, De Beers first responsibility is towards its own shareholders. One can hardly fault a company for taking advantage of its residual name recognition and influence to solidify a hold on the consumer market. Even when that far outweighs its actual current clout.

Moreover, one must admit that the Forevermark campaign shows flashes of sheer genius, albeit that we are still early days yet and it remains to be seen how the market will react to a marking system that effectively demotes to plonk status all diamonds previously obtained.

The regrettable passivity of the organisations whose job it is to represent the rest of the industry becomes more understandable when you realise that the executive leadership, clearly convinced of the need for an answer to the Forevermark, have the disadvantage of being forced to persuade their traditionally sceptical voting membership to devote the necessary effort and resources to a long term plan. This at a time when the future is uncertain and money is tight.

However, doing nothing is the luxury of sinecures.

If the market is to remain independent and fair, it must be led by a body unaffiliated to any government or commercial entity. It is clear that as long as membership to the Forevermark club remains elusive to some, and to be effective it must, it is in the interests of the wider market to have some form of alternative mark or else risk having all stones not entered into the program perceived as second rate, or worse,

as suspect.

Marketplaces being what they are, I have no doubt that alternatives will emerge. Human ingenuity being what it is I have confidence that the marketing community will find a ways to counter the threat of a new emerging monopoly. But that process will only start following realisation of what is actually afoot. The chorus of silence that greeted the new Forevermark release does not auger well in that respect.

Just mark my words. ■

management

Sailing the Seven Ss

Continuing our series of articles on strategy, the next few articles look at how strategy fits into the management of a company.

Ensuring that all parts of your organization work in harmony

How do you go about analyzing how well your organization is positioned to achieve its intended objective? This is a question that has been asked for many years, and there are many different answers. Some approaches look at internal factors, others look at external ones, some combine these perspectives, and others look for congruence between various aspects of the organization being studied. Ultimately, the issue comes down to which factors to study.

While some models of organizational effectiveness go in and out of fashion, one that has persisted is the McKinsey 7S framework. Developed in the early 1980s by Tom Peters and Robert Waterman, two consultants working at the McKinsey & Company consulting firm, the basic premise of the model is that there are seven internal aspects of an organization that need to be aligned if it is to be successful.

The 7S model can be used in a wide variety of situations where an alignment perspective is useful, for example to help you:

- Improve the performance of a company;
- Examine the likely effects of future changes within a company;
- Align departments and processes during a merger or acquisition; or
- Determine how best to implement a proposed strategy.

The McKinsey 7S model can be applied to elements of a team or a project as well. The alignment issues apply, regardless of how you decide to define the scope of the areas you study.

The Seven Elements

The McKinsey 7S model involves seven interdependent factors which are categorized as either "hard" or "soft" elements:

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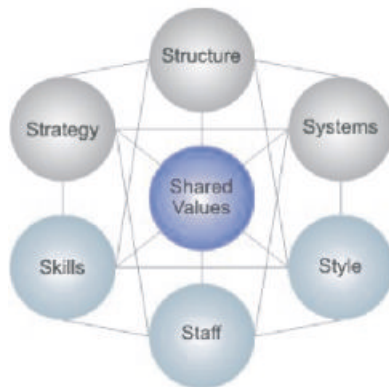
Hard Elements	Soft Elements
Strategy	Shared Values
Structure	Skills
Systems	Style
	Staff

"Hard" elements are easier to define or identify and management can directly influence them: These are strategy statements; organization charts and reporting lines; and formal processes and IT systems.

"Soft" elements, on the other hand, can be more difficult to describe, and are less tangible and more influenced by culture. However, these soft elements are as important as the hard elements if the organization is going to be successful.

The way the model is presented in Figure 1 below depicts the interdependency of the elements and indicates how a change in one affects all the others.

Figure 1: The McKinsey 7S Model



Let's look at each of the elements specifically:

- Strategy: the plan devised to maintain and build competitive advantage over the competition.
- Structure: the way the organization is structured and who reports to whom.
- Systems: the daily activities and procedures that staff members engage in to get the job done.
- Shared Values: called "superordinate goals" when the model was first developed, these are the core values of the company that are evidenced in the corporate culture and the general work ethic.
- Style: the style of leadership adopted.
- Staff: the employees and their general capabilities.
- Skills: the actual skills and competencies of the employees working for the company.

Placing Shared Values in the middle of the model emphasizes that these values are central to the development of all the other critical elements. The company's structure, strategy, systems, style, staff and skills all stem from why the organization was originally created, and what it stands for. The original vision of the company was formed from the values of the creators. As the values change, so do all the other elements.

In the next edition of Diamond Finance, we shall look at how to use the 7S model.

Quote of the Month

EVERY CLOUD HAS A SILVER LINING

John Milton's masque 'Comus' (1634) gave rise to the current proverb with the lines;

'Was I deceiv'd, or did a sable cloud
Turn forth her silver lining on the night?'



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An Interesting Problem part II

Last year, the Swiss government's Federal Department of Finance released figures showing the amount of tax withheld from the savings of individuals resident in EU member states under the Directive.

The gross revenue generated from the imposition of Switzerland's system of tax retention on interest payments in Switzerland, on earnings liable to tax in the EU for the 2006 tax year, amounted to CHF536.7 million (EUR327 million). For the second half of 2005 the amount collected was CHF159.4 million.

Overall in 2006, approximately 55,000 declarations were received (35,376 declarations were received for the second half of 2005). The agreement on the taxation of savings income with the European Community in force since 1 July 2005 makes provision for 75% of the proceeds to be passed on to the member states concerned. 25% goes to the Confederation, of which 10% is passed on to the cantons. This meant that CHF402.54 million was passed on to EU member states, while Switzerland's share amounted to CHF134.18 million.

The figures show that by far the largest sums were remitted to Germany (CHF103.4 million) and Italy (CHF103 million).

Although a substantial sum appears to have been collected, it has to be set against the total of assets supposed to be held in Switzerland. Assuming a withholding rate of 15%, and a rate of return of 6%, the amount collected represents underlying capital of 36 billion euros, less than 3% of assets held in Swiss banks.

Jersey also reported disappointing figures for the first year of the Directive. Individuals who reside in an EU Member State with relevant savings income arising in Jersey can opt for information on the savings income received to be exchanged with their domestic tax authority rather than be liable to the retention tax. It is estimated that approximately 30% have chosen this option, but the Jersey authorities expect this percentage to increase with time. (The retention tax will eventually increase to 35%).

A statement by the States of Jersey revealed that both the Comptroller of Income Tax and the President of the Jersey Bankers' Association are satisfied that the process of exchanging information and the retention of tax has worked smoothly.

"Both information and tax have been transferred efficiently to the Income Tax Department for onward transmission to the relevant competent authorities in the EU Member States before the 30 June 2006 as required under the Agreements," the statement explained.

Commenting, Senator Walker, Chief Minister, noted that: "This first payment of retention tax to the EU Member States is ample evidence, if it is needed, of the good neighbour policy we follow in our relations with the EU, a policy that we expect to see reciprocated." A straightforward calculation shows that, at 15% tax, with interest rates of 5%, the GBP13m collected would represent underlying deposits of GBP3.5bn. Since Jersey's assets, including bank deposits and investment funds, are nearly GBP350bn, according to a recent announcement by Jersey Finance, those figures suggest that only a tiny fraction of assets held on the island are being caught by the Directive.

Billions of euros in assets have reportedly flown to parts of the world where the EU directive cannot reach such as Hong Kong and Singapore, while in August 2005 alone, shortly after the directive entered into force, nearly EUR 7 billion poured out of Swiss accounts into Luxembourg Sicav II bonds, which are outside the scope of the Directive.

While opinions in the matter vary, it is generally thought that Hong Kong, Singapore and Dubai have benefited significantly from increased inflows of cash from European investors since the introduction of the directive.

The EU will probably be unsuccessful in its attempts to bring further countries under the Directive, but will clearly attempt to prepare a revised version of the Directive, which might include some or all of the following:

- A change in the definition of a Paying Agent to include foreign branches of banks who have headquarters within jurisdictions covered by the Directive, eg the Singapore branch of a UK bank.
- A change in the definition of beneficial owner to catch private companies if their ultimate owners are individuals resident in the EU, and the settlors of many types of discretionary trust if they are EU-resident.
- Inclusion of individuals who receive income through partnerships.
- All types of partnership will be covered - the partners will be treated as the owners.
- The definition of interest (returns on savings) to be broadened to include non-UCITS funds, unregulated funds, derivatives comprising or based on interest e.g. structured products, baskets, certificates and interest swaps.
- The inclusion of insurance companies as paying agents, and application of the Directive to interest received whether or not it is paid out to policy-holders.

While this may seem a scary list, it must be remembered that the EU had a difficult time trying to get agreement on the original Directive, and it is a certainty that countries such as Switzerland and Liechtenstein would resist such proposals to the death.

However, the EU still hasn't yet understood that there is a law of diminishing returns in the world of taxation. ■

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Please contact your professional, legal or financial advisors, for guidance.

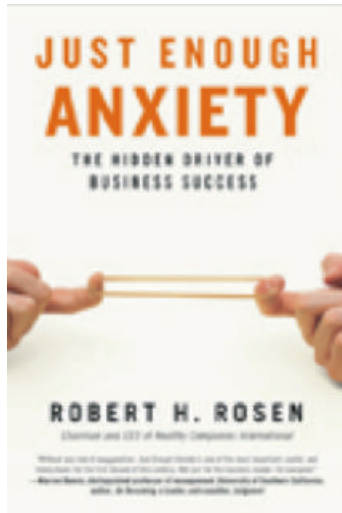
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Book Review



I don't want to panic you, but are you sure you aren't just slipping a little too easily into your comfort zone at the moment? But maybe that isn't really the problem. Perhaps you are, in fact, too anxious.

The American psychologist and consultant, Robert Rosen, has written a clever book which deals with this question of anxiousness head on. The book's thesis is not particularly complicated. For human beings and organisations to survive and thrive, he says, they need to avoid the complacency that envelops us when we settle in our respective comfort zones. And yet, having too much anxiety is exhausting, counterproductive and ultimately destructive.

This is not psychobabble or pseudo-scientific gobbledygook. Rosen is up to speed with the latest research into the science of the brain, and how we all think and react when under pressure. Panic stops us from using all of our intellectual capability and potential. But falling asleep is not a good business strategy.

Where Rosen is radical is in his suggestion that we need to embrace anxiety a little more enthusiastically if we are to continue developing at the right speed.

Just Enough Anxiety
The Hidden Driver of Business Success
By Robert H Rosen - Portfolio US\$24.95

'Let's face it,' he writes. 'The world is changing at an unprecedented pace. Anxiety is rapidly becoming our constant companion. If we continue to struggle against this natural process, we will remain locked in a closed loop of our own making. We will stop growing as individuals and organisations.'

Human beings have to change their act. 'The rate of change is outpacing our ability to reinvent ourselves,' adds Rosen. So we need 'to make new choices about how we handle change.'

One of Rosen's key witnesses is Todd Stitzer, chief executive of Cadbury Schweppes. Stitzer is clear that anxiety is useful to him. 'I'm an accomplishment junkie,' he tells the author. 'I love to challenge myself beyond my comfort level.' But anxiety has to be handled carefully. 'It's a constant challenge to modulate and manage your anxiety,' adds Stitzer. 'To not let your anxiety overwhelm you or get transmitted to others in a negative way.'

Rosen admits that humans have, in their evolutionary past, usually sought out calm and order. Stability has been seen as a sign of success. But stability may be dangerous, he argues. Better to live in the 'anxiety gap' between the problems and challenges of the present and the opportunities and dreams of the future.

That takes courage and confidence, and a desire to reject the quiet life. But human beings (and organisations) are like rubber bands, the author says. We have to be stretched a little to perform our best. In case you have not got the point, the cover of the book shows a pair of hands stretching (but not snapping) a rubber band.

Rosen's tough but useful message is this: 'It's time to embrace change, uncertainty and anxiety as facts of life...we can use our healthy anxiety as a positive force for growth...just enough anxiety is the key to living and leading in our complex world.'

I would be worried about this if I were you but not too much.

This review, by Stefan Stern, a columnist for the Financial Times, originally appeared in Accounting & Business, published by the Association of Chartered Certified Accountants.

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Editor..... Jeremy Sulzbacher Ba FCCA, editor@diamondfinance.info

Advertising..... Shifra Senderowicz, advertise@diamondfinance.info

Classified.....classified@diamondfinance.info

Letters.....letters@diamondfinance.info

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