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Benefits from investments by enterprises in business change

Many benefits claimed in business cases are really just additional costs.

Value creation
However, it is true to say some benefits directly contribute to value. For example a price reduction by a supplier with no other changes to quality, delivery timescales or other terms of business and no knock on effects on any other part of the organisation. Similarly, increasing the price of the enterprise's goods and services, e.g. by less than the competition, which results in no loss of orders and/or customers would increase value.

Benefits
But business cases contain all manner of different types of benefits, for example:

- increasing productivity and efficiency,
- enhancing the brand,
- improving customer service,
- providing better information,
- improving employee morale,
- enhancing the infrastructure, and
- legal, regulatory and contractual compliance.

It is worth considering each of these.

Increasing productivity and efficiency
This only contributes to value if costs actually diminish, e.g. by reducing staffing levels and saving salaries and/or more profit arising from sales, e.g. by each sales person bringing in more business so the unit cost of sales is reduced.

Likewise, if assets are sweated to produce more goods, then that only increases value if and when those goods are sold profitably and assuming maintenance costs do not rise disproportionately.

If products are re-designed so that they consume less or cheaper materials and customers continue to buy them in the same quantities at the original price, that would increase value.

Note that in each case something more, e.g. dismissing people, selling more, needs to happen to ensure value is created by reducing actual costs and/or increasing revenue. Improving productivity/efficiency alone is not enough.

Enhancing the brand
This only contributes to value if, again, more is sold profitably and net income exceeds the investment in enhancing the brand.

If there are on-going expenditures on promoting the brand, e.g. regular media advertising, then these expenditures are not really investments but costs of being in business. Increasing such expenditures would be an investment, so the extra spend needs to be linked to increased value.

Improving customer service
This depends on two factors:

a) the cost of providing different levels of service; and

b) the revenue which arises from different levels of service.

What matters is not improving the absolute level of customer service, but providing that level of service which maximises the difference between b) and a). It might be that reducing the level of customer service might actually increase profit or that the investment needed to improve service levels will not generate sufficient extra revenue to cover that investment. Of course, this must be considered over the longer term and not just as a quick profit making foray.

Providing better information
To whom is this going to be provided and what are they going to do differently once they have it? This is similar to the points in a) and b) above, e.g. what information is necessary and sufficient to create additional value? Note that providing the information only increases costs. The value comes from what is done differently by people once they have that information.

There must be some upper limit on what information is to be produced (and so the cost of producing it), rather than just "better".

Improving employee morale
For many employees, shortening working hours and increasing pay rates would improve their morale (at least in the immediate term). But again, a balance has to be struck between the cost of labour, including recruitment, induction, training, salary, benefits, expenses, supervision

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etc. and what those employees contribute towards value.

Poor morale might result in a high attrition rate and so high recruitment, training and other one-off costs. Hence there might be a case for incurring extra costs but the benefits of doing so must exceed those costs for value to be created.

Enhancing the infrastructure
On its own this is far from sufficient justification to claim it as a benefit.

How will value increase by improving the infrastructure? It is quite likely, if it has any merit, that enhancing the infrastructure contributes to one or more other benefits and they, in turn, contribute to creating more value. For example, better equipment might help some employees to be more productive or improve their morale. As infrastructure has to be used by someone as part of the process of creating value, then the key point is: who will use the improvements to achieve what?

Compliance
If the enterprise functions within a regulated activity, e.g. in the financial or pharmaceutical sectors, then such regulatory compliance, of itself, is just a cost of being in that business and not an investment; just as would be the case with legislative and contractual compliance.

However, it might be that other benefits could arise from the work needed to achieve compliance, e.g. internal business practices could be streamlined to make employees more efficient or early compliance might enhance the brand and provide competitive advantage.

Intermediate benefits
All of the benefits listed above are what some call "intermediate benefits", i.e. of themselves they do not directly contribute to extra value. Further activities are needed to follow-on after them to create that value by increasing income and/or reducing on-going costs.

Some argue that the linkage between these intermediate benefits and value is unclear or too complex to assess but enterprises employ line managers, marketing managers, customer service managers, HR managers and many others besides who should have an in-depth understanding of how their functions contribute to value. Why is their expertise neglected in establishing that linkage?

Investment portfolios
Some categorise their investments based on the above types of benefits. This is often because among the executive each of these has a spokesperson, e.g the Marketing Director, HR Director, IT Director etc. This leaves the executives vying among themselves for their share of the investment pot and it fails to provide a way of ranking all investments on the basis of how each contributes to value creation, which is the ultimate objective.

This is one of a series of papers on Grosvenor's Value Management. Others cover:

- vision,
- investments,
- capabilites,
- change and
- value.

Together they describe the journey from envisioning the future state of the enterprise to bringing it about through the selection and management of investments in business change.

For further information or a conversation on Value Management please contact:

Chris Tiernan on +44(0)7831 664 281 or
c.tiernan@grosvenorconsultancy.com

Carolyn Jacks on +44(0)7775 811 502 or
c.jacks@grosvenorconsultancy.com

Grosvenor Consultancy Services LLP
Thames House
5 Church Street
Twickenham
Middlesex
TW1 3NJ
United Kingdom
Telephone: + 44 (0)20 8891 6767
Fax: +44 (0)20 8891 1177
www.grosvenorconsultancy.com