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Investing in your enterprise

Unless investments actually create value, they can only serve to destroyit, in which case it would be better not to waste time and money on them.

All enterprises need to invest in themselves continuously so as to enhance current and to create new products and services; to retain existing and secure new customers and to improve the way they work. Some of these investments, e.g. R&D and marketing, will have regular annual budgets but others may be necessary, on an ad hoc basis, to make step changes, e.g. in production or service capabilities. For these, especially the more significant ones, business cases are likely to be prepared.

Business cases

Enterprises differ markedly in what they include in their business cases. Some treat them purely as financial controls around capital expenditure. Others require detailed descriptions of how the investment being sought will be commuted into value for those the enterprise serves – i.e. shareholders, in the case of commercial companies.

Some dismiss the need for rigorous business cases. These enterprises might rely on the intuition of the Executive or feel that business cases are a waste of time or that they are currently so successful that they do not believe they need them. The Executive often see business cases as works of fiction written by management to secure their share of the investment pot.

All will agree some form of record is needed of how much is to be spent, on what, to achieve some desired outcome. The issue is really about how detailed that record should be, especially when substantial sums are being spent on ad hoc activities for which there might be no precedent.

Risks

There will inevitably be a time lag between spending money and when the desired value is to be realised. Much can change over that time and many assumptions made at the outset might prove to be invalid. New factors might emerge, like changes to customer buying patterns and technology, which mean the original path to the value sought has to be altered.

This means investment programmes need continuous steering by the Executive as, from time to time, it might even be necessary to set a completely new course to secure the envisaged value (or perhaps exploit new opportunities to create even more value) or to abandon particular investments before more value is destroyed.

Complexity

The highly integrated nature of most enterprises inevitably means that a material change in one part will affect multiple other parts of the enterprise. For example, improving customer service can place greater demands on product and service supply chains; reducing inventories to save working capital might lose customers who are in a hurry to buy.

Additional value creation requires a very careful rebalancing of the entire enterprise at a new norm. That is an extremely complex task and requires considerable scrutiny by the Executive, on an on-going basis, as the world around it and, indeed, internally the enterprise keeps changing.

This calls for a large body of evidence, substantiated where possible and before each investment is approved, that value is likely to be created. It is prudent to fund each investment in tranches and for the Executive to reappraise the overall investment on a regular basis, with the latest updated evidence, before the next tranche is approved. At each review, business budgets, forecasts and targets should be adjusted in line with costs and benefits sought.

Reassessing investments

Those assessing their personal investments, say their shares in another enterprise, periodically examine their future prospects to determine whether to hold, sell or buy more, i.e. it is their future which is important. However, internal investments in enterprises are typically reviewed on the basis of whether they are on budget, on time and have delivered what was expected from that expenditure, i.e. what has happened. Yet what is really important is the answer to the question: how much do we (still) have to spend to get the value we are seeking?

This is exactly the same question which should have been asked before approving the investment at the outset. In other words, all investments, both new and running, should be periodically scrutinised in exactly the same way and compete for resources to identify the best. Looking back might provide insight into the credibility of the sponsor, which can inform the future, but it is the future which is important because nothing can be done about sunk costs.

Cancelling an investment is not an indication of poor management. It demonstrates good stewardship of resources. If any investment does not create value it will only destroy it – there is no middle ground – so kill it quickly.

Managing a portfolio of internal investments

At any point in time, every enterprise will have a number of potential investments which it could make to improve its business. Innovative ideas can occur at any time and do not neatly align with budget years. Their origin might be in various parts of the organisation. Many could substantially affect the future wellbeing of the enterprise, so they need to be captured and assessed. This should be an on-going practice.

Most enterprises have more ideas for making investments than their resources can fund or, in terms of expertise, can bring to fruition. Those demands can span from mandatory regulatory changes, to new market opportunities, new sources of supply of materials, talent and technologies, to the CEO's bright ideas. Investments and resources need to be allocated to obtain the best outcome for those the enterprise exists to serve. Transparent criteria need to be set and reviewed in line with business strategy.

Key criteria often include: how the investment will advance attainment of the enterprise strategy, the value to be created, the investment and expertise needed and how each of these might be affected by risks. All prospective investments might compete for the same pot or there might be pre-set pots for different categories of investments. There might be separate arrangements for mandatory changes and the CEO's own pot, for example. No matter how many pots, the overall objective is to optimise the value which is created from the limited investment resources.

Benefits registers

It is quite possible that the returns expected from the investments will have a very substantial bearing on the future net income of the enterprise. They will determine its future success or demise.

With multiple investment programmes running concurrently, it is very helpful to ensure benefits are tracked from the point of investment approval and that none is counted twice by different programmes. This calls for a register of benefits, similar to the traditional asset register, where a record is kept of what the benefits are envisaged to be, together with who is responsible for realising them.

If, over the investment portfolio, the returns are good, then more funds will be available in future for further investments thus enabling year on year growth. If, on review, any particular investments look unlikely to deliver acceptable returns (or better opportunities arise), they should be adjusted or curtailed as soon as possible to avoid value destruction.

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

- vision,
- capabilities,
- business benefits,
- change and
- value.

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