Decision Making Made Easy

Proving a Concept with a Decision Making Model

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Has this happened to you? You are sitting in a meeting and an executive from another department utters a few (not too well thought out) words and the next thing you know, you are assigned the task of proving the feasibility of the idea? Perhaps it is an idea to merge with or acquire another company, make a large purchase, or to prove a new revenue stream. Feasibility studies usually entail a lot of preliminary research on alternatives to build a model from the ground up. Alternatives are evaluated while considering human resources; software, hardware and technology requirements; operations; engineering; marketing; finance; legal considerations; organizational structure; administration; facilities; ergonomics; customer expectations; customer input; process evaluation; measurements; impact of this alternative on other company projects; competition; trends; outsourcers; and risks. In short, a good feasibility study is a lot of work.

What if the company had a tool that required the preliminary proof of concept to be on the shoulders of the person suggesting it? What if the company had a tool that was easy to use as a first hurdle before developing a full fledged feasibility model? A screening model can be developed for the decision making team to use to assess alternatives. The advantage of creating a screening model is to assure everyone understands the evaluation criteria and the priorities of the company.

If this tool were endorsed by the top executives, it could change the decision making culture of the business. The tool is built with decision criteria behind the scenes. The decision criteria contain the company's basic minimum metric ranges such as desired cash flow margin range; NPV; IRR; cash flow positive months; CapEx requirements and ability to control. The behind-the-scenes decision criteria include quantifiable as well as qualified ranges. Qualified ranges include an assessment of the investor value; level and benefit of strategic and operational synergies; customer and target market; product life span and information management and operational requirements. If the questions are answered properly, the tool will tell the executive whether or not the idea is worth pursuing. The executive can do the preliminary work before ever asking finance or business development to build a full-fledged model. Once the tool shows a favorable outcome, then a more detailed model can be developed.

Does it sound too good to be true -- to be able to build a cash flow and prove the feasibility of a new revenue stream without having to start with a blank spreadsheet each time? It can be done. This article will discuss how to design a decision making tool to prove the feasibility of a new revenue stream, concept or purchase.

A feasibility study is completed to justify an objective or concept. It is used to provide a cost/benefit analysis as well as a thorough analysis of impacted stakeholders. Usually several different alternatives are considered and weighed against each other. The objective of a feasibility study is to determine the right alternative.

The tool assumes that the company is currently in business with other profitable revenue streams. Questions in the tool need to be answered based on what is needed incrementally to support this concept. The model allows the executive to answer questions with text, as well as with dropdowns. The dropdown information is fed into the behind-the-scenes decision criteria which is pre-established by the company. Depending on the answers to the text and dropdown questions, at the end of the model, the executive will receive a go / no go decision. The text answers help the assessor determine whether the dropdown answer is valid and believable.

Tab 1 – Text and Dropdowns

The first section of the model deals with the basic description of the business and questions about synergies with the existing product line and with the existing company strategy. It also asks for a discussion of the value proposition. For example, does the new product/service increase subscribers, expand the market, diminish churn, and benefit investors? Other introductory questions include: How does this business work? A diagram or narrative is requested. What is the exit strategy? Will the business be built up and then sold off, or incorporated with the existing product line as complimentary services? What are trends in the existing market that would be addressed with this product? The dropdown gives the option of low / medium / high for each of the questions. Dropdown options can be adjusted to accommodate the range of answers in the decision criteria.

The next section entails thinking through the incremental impact of this product line on sales / marketing, engineering, operations, G&A and required capital expenses. A matrix asks whether the current team can handle the demands of this business and if not, what other talent is required. For example operation questions ask if there is a need for 24/7 support, or a truck roll, or additional staff to handle this new product/service.

Targeted market and competition are evaluated. The executive is asked to fill out a small table that discusses competitors, products offered, target market, pricing, geographic area, and current market share. Distribution channels are offered. Sections include internal, external, web advertising, direct mail, vendors, manufacturing company, programmers. Market control is also assessed – how much influence does this company have on pricing? Is the service unique enough to command its own price, or is it a market driven commodity-based price scenario?

Management and operational requirements entail thinking about the required team, the support from other contributing departments and the timing, the level of experience of the company and the overall assessment of impact on the existing business. Dropdowns ask for low / medium / high as well as text answers. Risk factors and mitigation strategies are assessed.

Tab 2 – Financial Analysis

The financial section offers an easy way for the executive to enter the basic assumptions. Keeping in mind that this is a high-level first cut model, the base variable is entered one time, and the annual percent change is entered. The cash flow automatically builds itself in a year to year model growing at the percent change entered initially. Variable sections include market size, total average customers and total penetration. The revenue summary includes monthly revenue per customer, split with partner, partner flat fee and installation / activation charges. Capital expenditures are one line item asking for incremental capital expenses for this new product/service. A report is automatically built showing a summary of the information entered in this section. Another report showing the allocation expense summary (what percent of all expenses are allocated to each functional group)? Using these two outputs, the proposing executive would be able to look at this high level, back of the envelope cash flow and decide whether or not the idea is worth pursuing.

Tab 3 – Decision Criteria
(Note, this tab is hidden from those using the form. It is for the New Business Development, the Financial Department or the Decision Team to use to screen the proposed ideas.) The company could decide to have a decision making team, or to have one person assess the proposed ideas. The heart of this tool rests on the decision criteria. Before ever issuing the tool to the executive team, the company has to make some fundamental decisions about the criteria they use to decide to pursue a proposed revenue stream. The tool is built to feed the dropdown choices given by the executive into an if/then model that contains the desired criteria for each category. For example, one of the categories is Investor Value added / created. The desired answer to this in the decision criteria is "high". Another question regarding the legal contractual advantage could offer choices of "exclusive or non-exclusive". The desired answer to these criteria is "exclusive". Financial criteria include cash flow margin, and the desired percent range; NPV percentage desired; IRR, cash flow positive month, Capex requirements and ability to control costs. Obviously, a smart executive can guess the desired answers, however, they have been asked to provide supporting arguments and back up in the text boxes in the tool. The assessing team will compare the answers to the supporting text to determine if the answers are consistent.

Summary
This is a high-level model that helps screen out good ideas in a short period of time. The tool is built with drop downs and easy variables to fill in. It takes some time to set it up for each unique business, and to come to a consensus as a team on the desired outcomes in the screening criteria, but it is worth it. It helps the proposing executive think through an idea before presenting it. Utilizing this type of decision making tool has several advantages besides saving the financial or the new business development hours of labor -- it requires that the proposing executive think through some of the preliminary assumptions. The burden of proof falls on the proposing executive rather than to the finance or business development department. It provides finance with some preliminary information, the thought process, and base assumptions to use. It allows the company to screen a lot more ideas than they ever could if they had to build a model from the ground up each time. It also involves cross-functional input. The proposing executive will likely need to ask other groups to "weigh in" to answer the questions regarding marketing, engineering and operations.

A company could consider having a cross-functional decision making team which meets periodically to assess model outputs. This could create a culture that encourages a consensus, and well-thought-out decisions from a variety of perspectives. Or, the completed models could be submitted to finance or new business development for consideration. Either way, this method saves a lot of time and helps the proposing executive to think through the feasibility of deploying a new revenue stream, acquiring or merging with another company, or making a significant purchase.

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