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1 Foreword

One of the most frequent issue that I advise up on is whether or not a plan of change for a business makes sense.

Businesses consider this question with a wide spectrum of philosophies that typically reflect their own individual management cultures and experience: 'It'll be fine, we know our business'; '3-year payback is fine'; 'risks! what risks!'; 'after a full analysis of the costs and benefits and a statistical analysis of the risks we are 90% confident'.

This article considers the assessment of plans and how businesses can test their veracity.

2 Are the objectives sensible?

Objectives of a plan should

- align with the agreed strategy of the business
- focus on what is to be achieved rather than just describing what will be done

Any plan should be developed with the aim of supporting the attainment of an operational/functional objective for the business, which should in turn have been derived from an agreed, strategic objective. For example, if a UK business is proposing a plan to sell products in Spain, but the strategy doesn't mention International sales, then there is a risk that a personal agenda / misaligned manager is acting too independently. If there is a proposal to invest in production but the strategy is one of outsourcing then there may be a need for re-alignment. If a business is considering creating a network of sales staff to target builders direct but the strategy is to trade via distributors and stockists then what issue is someone trying to address? Implementing plans that do not align with the current strategy typically lead to confusion and under-performance. The reason for doing so may be the failure of the existing strategy to achieve specific goals. But that is a different issue and often one that isn't addressed sufficiently at the time as the very act of going 'off-piste' is often the result of a break-down of teamwork, trust or belief at the Executive level. That doesn't mean, however, that the plan isn't sensible – it might be – and the Executive needs to meet to assess it and the reason that it is being proposed. Challenging the strategy can put in to question previous decisions and investments, which can be uncomfortable – but not necessarily a bad thing – that is a question of leadership.

If objectives focus solely on the physical changes that will take place such as; 'to build a new facility', 'to relocate a business unit', 'to trade in a new market', 'to launch a new product or service', 'to implement SAP'; then the focus of the plan is potentially too narrow. The measurement of the success of the change will not (should not) be limited to the successful implementation of the physical change, rather the actual results derived from it. Objectives should reflect the outcome; 'to reduce unit cost of production by x% or £x/unit ', 'grow export sales by x% in y years'; 'to increase sales and margin by £xK and £yK respectively from diversified sales'.

When considering the objectives of a plan businesses should;

- ensure the objective(s) aligns with the strategy
- define the outcome in a quantified manner as well as describing the physical changes required

3 Does it make financial sense?

When a business enters a period of change it is, by definition, entering a phase of transient performance. Management accountants want to understand the impact on costs, margin and profit in future periods while the financial accountants will want to understand the impact on cash-flow, cash requirements and the balance sheet. Businesses can over-stretch their finances by implementing changes – and they can 'get in to trouble' – over ambition can lead to failure, just ask Icarus.

Financial accountants will check that the proposed nett cash-flows are in line with those previously forecast in the latest budget / management plan. If a plan creates a need for, or risk of, unplanned borrowing or the unexpected need to raise money from equity then it probably doesn't align with the agreed strategic objectives of the business; either their content or timing. Any variance should lead to an 'affordability' decision by the Executive, probably before too much effort is invested in more detailed analysis, and certainly before the change is progressed.

The classical approach to assessing the financial acceptability of a plan to change a business is the creation of a cash-flow model and the generation of various financial ratios. A cash-flow model considers positive (in-flows), negative (out-flows) and the nett (difference between positive and negative). Typical contributors to cash-flows are;

- Positive cash-flows; reduced costs in future periods, additional gross margin from additional sales, one off revenues from asset sales
- Negative cash-flows; costs for restructuring a work-force (recruitment and redundancy), increased costs in future periods (additional; staff, rent and rates, other costs)

The timing of cash-flows can, in the first instance, be rough-cut. Typically models for major changes are constructed in yearly periods. The timing of the costs and the one-off benefit from asset sales can be considered in relation to major milestones in the schedule while the timing and ramp-up of the benefits, especially those for sales growth, can tend to be more speculative.

Typical ratios include; Internal Rate of Return (IRR), Return on Capital Employed (ROCE), simple payback measured in years, incremental Earnings Before Interest and Tax (EBIT), Net Present Value (NPV). These can all be assessed from a cash-flow model, with EBIT being derived with the addition of an assessment of depreciation. Which measure is most important or relevant depends partly on the strategic objectives for the business and on the personal preference(s) of the Executive.

It is good practice to develop a cash-flow model based on the most likely set of assumptions – which should be clearly documented. This, initial model is termed the 'base case'. I recommend that the base-case be tested to destruction, that is a stress-testing of the costs and the benefits and their timing. Typically, the base case should be tested by

- Inflating the costs and decreasing the benefits by 25% and 50%
- Delaying the commencement of benefits by 1 year and ramping them up over twice the base case assumption
- Combining the above two tests

The outcome is a table of ratios listed by 'cases'. The sensitivity of the business case to these different drivers provides evidence of the strength, or robustness, of the plan. The most influential parameters should be fed into the assessment of the risks.

The Executive needs to decide

- Is the plan affordable?
- Are the returns sufficiently attractive?
- Is the business case robust?
- Is the level of risk acceptable?

4 Is it realistic?

The proposers for any plan or course of action tend towards optimism driven by enthusiasm. This can lead to overly aggressive timelines, undercooking of costs and a lack of attention to the risks. A 'rose tinted' perspective can develop that can turn in to what I term 'The Kings New clothes Plan', that is a plan that gains such personal sponsorship and support from 'the top' or 'the owner' that no-one dares, or even considers, to question whether it is realistic. Realism should be developed from a blend of vision / enthusiasm and solid, pragmatic analysis. Some of the issues that should be considered to test whether a plan is realistic are;

- the schedule, in particular the duration of the main activities and those on the critical path
- the capability and capacity of the organisation to complete the required work and to achieve the new state
- the accuracy of the cost estimates and their likely timing
- the scale of the benefits, the timing of their commencement and the profile of their growth to the maximum potential

Schedule

Schedules should be constructed by people who are experienced in the specific elements of change required by the plan. Experts can be used to give professional estimates for

- physical changes to property; acquisition, lease lead-times, construction, fit-out;
- asset changes; machine purchase and commissioning, system upgrades / implementation;
- restructuring the workforce; redundancy, recruitment, training;
- placing / winning commercial contracts; tendering, selection, contract negotiation and award.

Experienced schedulers can map out a schedule, developing the dependencies and considering any constraints. Using skilled and experienced resources that have a degree of independence to the main sponsors and owners of the plan creates a healthy tension. Once a base-line schedule is complete it can be used to tune the cash-flow model. It can also be tested using confidence modelling – this places a statistical deviation on the durations of the activities and on any milestones, that are triggered by external events. By applying these deviations to the schedule, it is possible to get 'best and worst' case versions of the timeline, including the critical path. These can be used as inputs to the stress testing of the cash-flow model if required.

The development of a schedule, including dependencies, is also a useful test of the scope of a project. As the schedule develops activities or deliverables may be identified within the logic of the plan. These should be added to the definition for the project, and if required highlighted as formal changes.

Capability and capacity

Managing a project to successfully guide a business through a transition requires a different skill set to 'simply' managing 'business as usual'. Some managers, especially ones who have previous experience of change, may have the skills required to support the change in their function. Few managers have the broadness of experience to manage a multi-functional change process or to have the bandwidth to manage daily business and transformational change. Placing too much responsibility on a narrow range of staff is also a risk. So, the positions of Change Manager, Business Transformation Manager/Director, Programme or Project Manager are usually applied and filled with specialists or those rare senior managers with the breadth of knowledge. In large scale changes, there may also be Project Accountants, Work Package Managers, Risk Managers, Schedulers. Often, in large scale projects this 'project organisation' may be outsourced to a third party by official tender. The project team that is formed should provide a wealth of experience to ensure the success of the plan. Clearly this can be expensive and will only be applied in full to major investments and changes. However, if the risks of a plan go as far as the potential failure of a business then the cost of a team may be a 'necessary evil' – it is likely that a risk assessment would identify a capability gap with the mitigating action being its closure.

For smaller changes businesses have can self-manage all aspects. This can work, however, if the 'project' staff are also fulfilling 'day-job' roles then experience suggests that the projects receive insufficient effort. One of the main reasons for failure of projects is 'insufficient resources'. So, it is recommended that at least some full-time staff are dedicated to a change. This can include people drawn externally in key positions.

As a change progresses formal reporting should be provided, especially for the completion of key tasks, the provision of key deliverables on time and to the required standard, or the successful completion of milestones. If there is slippage the root cause(s) should be assessed. Resourcing and capability gaps should be addressed.

Accuracy of costs

The costs of undertaking a project / plan tend to rise rather than fall during the lifecycle of the change. This can be as a result of changes to scope. But it can also be due to poor estimates. There are published standards that can be applied to assess the quality of cost estimates. They assess the 'basis of estimate'; ranging from an internal estimate, a quote or series of quotes from suppliers, to a fixed price. Differing confidence levels are applied and this leads to a range being established for the potential cost of the plan, or elements of it.

The assumptions that have been used should also be logged. For example, if redundancies are required is the National minimum level of redundancy being used or are there enhancements. Is a notice period to be worked or not? What assumptions have been made about the profile of the workforce that may be affected; service levels, age?

If a new property is to be acquired are the values assumed just typical benchmarks or based on a specific property. And how have the estimates for any alterations been costed.

If the method used for assessing the costs of a plan are quite rudimentary, are based on a set of narrow opinions / experience and is applied before a detailed schedule has been developed then it is possible that reality could be 50 to 100% higher.

The development of the costs of a plan should be iterative. Initial estimates with a broad tolerance can be used in the early stages of analysis. But as the planning process develops, and business decisions are required, the estimates should be improved and, where possible, become fixed – or with a known, narrow spread based on an understanding of risk and opportunity. Large companies often have policies defined for the source of cost estimates.

Consideration should also be taken of any transitory costs; temporary labour, one off logistics costs, equipment rental, relocation.

Scale and timing of benefits

Some of the main financial benefits of a plan could be

- reduced costs
- cost avoidance
- additional margin from new sales

A reduction in costs can be assessed quite easily. The comparison of the current and future cost bases can usually be done quite quickly and the main savings confirmed. But how likely is it that the cost reduction will be achieved? Can headcount be reduced to the planned level? Will the future business fit into the proposed property footprint? Will the new manufacturing process reduce waste by the planned amount? It is important to challenge the rationale for the savings. Assessing the likelihood of success, or degree of it.

Cost avoidance is achieved when the actions in a plan reduce the forecasted costs in the future if nothing changed. A forecast increase could be being driven by growth that is leading to incremental costs, or by an investment required to meet compliance to new legislation or due to the increasing maintenance costs of aging assets. Businesses have a tendency to absorb these types of costs at the expense of profit.

If the plan includes growth then additional margin and contribution will be generated in future periods. How likely is this? If the business is taking market share how will competitors react? Will planned prices be maintained? If the market or product are new how thorough has the market research been? Are there already future commitments from customers? Growth is a risky benefit. Sensitivity analysis is a must. And have all of the additional costs for coping with this growth been included?

5 Could risk destroy value?

Once a plan has reached a good level of maturity, and certainly before business decisions are made a thorough risk and opportunity assessment should be completed. This is often facilitated by a risk professional who is external to the project and potentially to the sponsoring business. The process of completing the assessment can include a mix of techniques such as group sessions of key stakeholders, 1-2-1 interviews, and desk-based studies. The assessment should test the potential failure points and their impact and any additional opportunities that may arise. There are many potential failure points such as;

- The schedule not being met
- The costs for the change over-running
- The future benefits not being met, and/or being delayed
- The change not working, that is it doesn't deliver what it was meant to either in full or partly

Once the risks are listed the likely causes and timing of their realisation into issues can be derived and mitigating actions proposed. Some of these actions may include additional expenses that should be included in the business case. And the actions can be added to the schedule.

If a thorough, serious analysis of the potential failure of a plan is considered in the early stages of planning then robust responses can be implemented / planned / allowed for. The project manager, and the risk manager if there is one, can periodically review risks in a structured way and can consider appropriate responses. When mitigating actions are embedded in the schedule a proactive approach to managing risk is established and the risks rarely occur.

If 'surprises' and 'unexpected changes' become a feature of an implementation then the risk analysis has been inadequate and a good project manager would trigger a re-assessment.

6 Summary

Plans that make sense can be produced that ensure that a change leads to the expected result.

Sound planning by professionals coupled with a business team in a challenging and supportive partnership is a recipe for success. If the strengths and weaknesses of a business case are understood, a realistic schedule is prepared and tested, and a thorough understanding of risk and opportunity is developed, then the Executive can make an informed decision. Controlled and predictable change that delivers the expected returns can be achieved.

The process that will have led to this point will have educated all of the participants about the plan to a greater depth than may otherwise have occurred. There will, therefore, be a strong understanding of the critical success factors and the plan will have a good chance of succeeding.

7 Contact

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