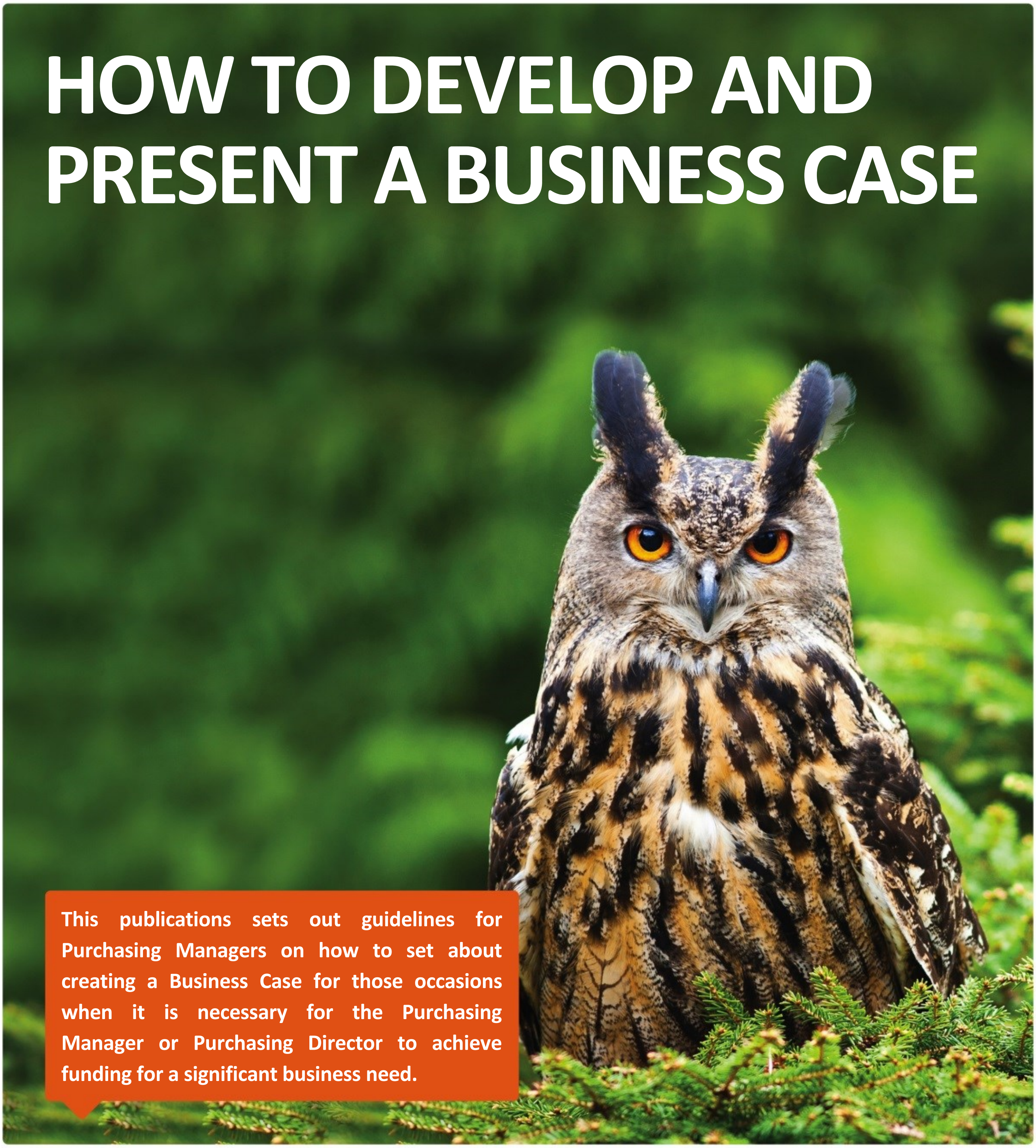
CIPS How To

CIPS KNOWLEDGE

HOW TO DEVELOP AND PRESENT A BUSINESS CASE



This publications sets out guidelines for Purchasing Managers on how to set about creating a Business Case for those occasions when it is necessary for the Purchasing Manager or Purchasing Director to achieve funding for a significant business need.

1 CPD HOURS

CIPS members can record one CPD hour for reading a CIPS Knowledge download that displays a CIPS CPD icon.

CONTENTS

Introduction

Early on in any capital project it is important for Purchasing Directors and Purchasing Managers, and indeed the other managers in a business who are responsible for the processes which relate to the Supply Chain, to remember that at some early point in all project processes they are going to have to approach the people in the organisation who hold the purse-strings and ask for finance. These individuals are usually less than impressed by unrealistic and unachievable promises and will instead be unemotionally asking hard-nosed questions about the important considerations like **payback** and **measurable benefits**.

Many organisations have no idea how much they are spending on purchases because everything from the Travel and Entertainment Expenses budget, Direct Debits to the General Ledger, the Corporate Card, the Petty Cash Box, Purchase Credit Cards, the departmental cheque book through to rebated supply arrangements are used in companies to pay for goods and services from outside suppliers. All of these are in addition of course to the principal spending vehicle, the Purchase Ledger. Indeed, even for the primary payment point, most decentralised organisations now provide for the creation of many dedicated Purchase Ledgers for each of the discrete business units, and so even a trawl of this Purchase Ledger database cannot guarantee that the analysis will be comprehensive. Despite this, before any Business Case can be made for a Purchasing need it is essential that some reasonably accurate assessment is made of what is being bought and what is being spent, from whom, and why. Only when the full picture is known can a reliable estimate be made of the possible savings: that is primarily what the 'purse-strings' managers will want to know.

As well as the actual cost of the goods and services being looked at as a possible area of saving there is an equally significant savings potential from the cost associated with the processing of purchases. If an organisation was able to calculate the total number of "man days" spent in all departments on Purchasing activity they would find that they invariably dwarf the direct costs which are incurred inside the departments intimately involved in the acquisition of goods and services (ie. Procurement/Purchasing; Purchase Ledger; Storekeeping; Warehousing, etc). Much of the processing of Purchase transactions (not least for the low-value items) is still quite labour-intensive and so any opportunity for speeding up the process becomes significant.

In addition to the Cost/Benefit Analysis the person in the Purchasing department responsible for drawing up the Business Case also has to build two other key "deliverables" into his presentation:

1. The need to win over the Board by demonstrating that the Purchasing Department proposal is fully in line with the company's strategic goals. To purchase software for instance is always a strategic decision and so the Business Case and accompanying papers and presentations will need to give confidence that there is a good strategic fit. Those responsible for drawing up the business case might well want to illustrate that the massively speeded up Procurement processes for example are more flexible and so a planned Company acquisition programme is greatly enhanced because such a system could be rapidly and painlessly expanded into any newly acquired businesses, bringing about a rapid reduction in overheads.

2. This has to do with the credibility of the Implementation Plan. Although it is not part of the brief of this booklet to present guidelines for project implementation programmes, without a doubt there has been plenty of historical evidence to show how costs of implementation can soon become excessive if not carefully thought

through in advance, and then robustly managed during the implementation process. Consequently, senior management needs to be satisfied that great care has been taken to ensure that a realistic, cost-controlled implementation programme has indeed been properly thought through.

A Business Case Model

Developing and implementing the business case can be greatly facilitated through the use of a ten-point model, conceived and developed by Alan Fenwick. This comprises the following elements:

1. Management Summary
2. Strategic Fit
3. Market Analysis
4. Project Proposal
5. Commercial Considerations
6. Financial Analysis
7. Risks and Sensitivities
8. Other Options
9. Implementation Issues
10. Recommendations

Management Summary

In the ‘Business Case‘ type of report it is generally good practice to provide a succinct and persuasive summary of what is wanted and why as early as possible in the document. The decision-maker will then know exactly what is required and can brace himself for the detailed arguments in the Report he will expect to hear to persuade him to produce the necessary financial resources. Top-line benefits and top-line costs should be presented in such a persuasive manner that he will want to read further and will be happy to accept the reasoning behind the proposal.

The Summary should incorporate the following sections:

- Introduction
- Description
- Decisions
- Discussion
- References

Introduction

This should provide a preliminary outline of he aims of the business case. It needs to be high impact but also brief, consistent with providing a sufficiently clear picture of what is being proposed.

Description

This will include a detailed and well-argued financial justification and cost-benefit analysis. Whatever the Business Case author's skills in this area might be, as far as the Management Summary is concerned only top line data is required. It is necessary to know what it is going to cost in total, how long will it take to pay this back and what tangible and quantifiable business opportunities will be opened up as a consequence? To offer up eProcurement for example as something that should have investment because it is fashionable, everybody else including the competition is doing it, it is state of the art etc etc, is an emotional argument and as such, extremely powerful. However, with the Finance Director this counts for nothing. It should be remembered that the decision-makers were recruited in part for their ability to distance themselves from the emotional argument. Rather, an in-depth analysis of the anticipated benefits needs to be carried out.

Two prime categories may be identified:

- Savings will be made on goods and services because it provides an opportunity to leverage spend and give wider access to and knowledge of the competitive market place, and

- The procurement process will be streamlined, with savings in costs, manpower, and reduced paperwork

These two benefits will need to be quantified in financial terms before the business case is drawn up; this is where most of the work and effort will need to have been done preparatory to the Business Case being finalised and presented

Decisions

This section needs to set out just what decisions are required in respect of the Business Case, including, where relevant, who the authorised signatories will be, and which Board Directors or which senior management group will have to give approval, in accordance with the appropriate company rules or procedures.

There is a considerable risk that to those having been involved in developing the project over weeks and months it will be obvious what the attractions and benefits are and that these will therefore also be readily apparent to the key decision-makers within the organisation. This is not necessarily the case. There are many demands on such individuals' time and it will be a large assumption on the part of those responsible for having drawn up the Business Case that senior management knows and understands the benefits. So, although this is the Management Summary and therefore the information must be provided in a concise form summary it is good practice to spell out exactly what actions are required from such individuals, as key decision-makers, to move the business case forward.

Discussions

These will feature an upfront declaration of what if any contentious topics are raised by the Business Case, such as cross-sector issues in a multi-national, multi-market organisation, or what other projects are competing for the same funds.

Closely linked to this is some discussion of whatever associated issues are current within the organisation at the time the Business Case is published. If these are not raised at this point by those responsible for drawing up the business case then they will invariably be raised (either at this stage or later) by the senior decision maker(s) This may well jeopardise the success of the Business Case. A further consideration is that if it is the Business Case author who raises the issue(s) then he will be in a strong position to downplay any factors which might be prejudicial to the success of his proposals.

References

Business Cases sometimes fail at the first attempt and so cross-referencing to previous papers or preliminary reports published earlier is important, plus of course reference to what might be a rather large volume of supporting papers that may be of interest to Senior Managers anxious to familiarise themselves with the fine detail.

All accounting processes form part of a continuum and so it is highly likely that the Purchasing Department's Business case has to be seen in the context of possible considerable financial planning and systems development activity. The writer of the Business Case needs therefore to put his paper into context, making reference to any other relevant work where appropriate. Indeed, it is also highly likely that even a superbly-drafted Business Case will not succeed at its first attempt but merely will result in requests for ever more information and ever more justification, and so referencing at the later stages of the Business Case programme helps to streamline the process.

Strategic Fit

A fundamental question is: to what extent do the Business Case proposals for action relate to the overall Business Strategy. This is crucial for, as indicated earlier, if the aspirations of the business case cannot be seen to be linked to the overall business aims then the likelihood of failure of the Business Case increases dramatically. If the writer of the Business Case does not know or cannot find out the company strategy from the Directors or Senior Managers (in particular, their position on process improvements and financial investment) then it is impossible to be sure whether or not he is not acting in accordance with the overall plan. They could be expecting to develop and therefore spend money on any number of financial management tools related to Supply Chain Management. Many businesses are considering outsourcing Purchasing and do not see the Purchasing Department as the new enabler of that process; in such circumstances the proposed Business Case could well be perceived as irrelevant, or at best marginal.

Market Analysis

This involves a comprehensive description of the supply market (size, growth rates, key trends, competition, respective market shares, leaders etc.).

The Purchasing department enjoys an enviable position. Where else other than in the Purchasing department would the recognition of the crucial importance of the competitive market place be recognised? Who else would be expected to provide detailed analysis of a market place which is becoming increasingly competitive by the day? The recommended sequence is: 1 Research; 2 Tendering 3 Bid Analysis 4 Auditing and supplier certification.

Unfortunately, many Purchasing Department Business Cases do not follow this pattern, demonstrating a lack of due diligence in the traditional Purchasing process to find the best and most competitive solution; instead there is more often than not merely a blind attachment to one favourite supplier. Ideally, those in a position of authority in the Procurement function should excel in this area of activity, demonstrating a high level of expertise and professionalism, including undertaking market analyses and rigorous comparisons of the range of alternatives which may be available. For example, many early adopters of e-procurement were sold very expensive systems to tackle low-value high-volume transactions based on over-inflated /hyped payback predictions; as a result it will be many years, if ever, before payback is achieved.

Project Proposal

This is the core of the Business Case, fully outlining what is being asked for and why. It is here where a detailed description is given as to the form of the proposed arrangement with the supplier.

By this stage a decision should have been made as to the product or service envisaged (and as a corollary, which supplier would be the preferred choice once financial approval has been secured). It is in this part of the Business Case therefore that the supplier's negotiated proposal - ie the preferred supplier's best and final Quotation – should be placed. Suppliers, it could be argued are a little better at marketing than the average Purchasing department and so it is acceptable to place reliance on the supplier in this respect. Suppliers will, however, need to realise that they have to work just as hard as the author of the Business Case to persuade management to allocate funds as they did to get into pole position, and for this reason they should be willing to adopt a positive attitude to the proposals. Furthermore, if the Purchasing Manager has been diligent, (as emphasised above) in his thorough application of the Purchasing process then developing a close relationship (not necessarily a partnership) with the preferred supplier should not be a problem - only if the Purchasing department has failed to follow their own rules on competitive bidding may any issues be expected to arise. There, would of course be serious implications in colluding with a given supplier to approach senior management for the required finance.

Consideration should also be given to asking the chosen supplier, before contracts are signed, to give a presentation to senior members of the organisation

Commercial Considerations

Information needs to be presented on what the key drivers behind the Business Case are and what the anticipated impact would be, not only on the Supply Chain but also on the business as a whole.

Too often purchasing projects are presented as a remedy for what may be termed ‘Maverick Buying’ (a maverick being succinctly defined in Chambers Dictionary as ‘a person who does not conform’. Maverick buyers may be described as ‘people who by-pass accepted purchasing processes and often buy off-contract. It does not follow however that the Purchasing Department's Unique Selling Proposition should be that it will make people conform? There are many other ways of getting mavericks to conform and comply with business control procedures that cost nothing, so it is difficult to see how can that feature be sold as a benefit. Furthermore there are many companies that do not want their people to conform; they prefer creativity.

It is certainly the case everyone wants easy-to-use systems and processes : fast, reliable, powerful, and accurate but even the most attractive and promising purchasing projects will not of their own accord make people conform - other financial control procedures and protocols do that. It also needs to be borne in mind that leading edge technology can soon become bleeding edge technology, so merely appearing to be merely up to date with the equipment, systems and services used by the team is, generally speaking, not going to impress the Financial Director.

Financial Analysis

This section would include a summary of IRR, NPV (defined below) and undiscounted payback period calculations, together with an assessment of the impact of the proposal on the Profit and Loss Account, monthly Cash Flow, and ROCE (Return on Capital Employed. Any legal or fiscal implications should also be raised at this point.

It is here too that all financial assumptions should be presented in detail; wherever possible these should be based on historical performance and prior experience.

Financial analysis is carried out in two distinct stages: firstly it looks at the investment in Purchasing in isolation to determine whether or not the anticipated return is good enough. Secondly, it evaluates the effect of spending this money on the company overall and the company's financing procedures. Cash flow forecasts (often based on presumptive forecasts, including for instance roll-outs and increasing market share) have to be made, and Business Case authors have to realise the hard truth that even the most time-efficient payback proposal will be unsuccessful if the cash flow position of the company is at risk. Consequently, the business case will need now to concentrate on justification through investment analysis using techniques such as Payback, Accounting Rate of Return (otherwise known as Return on Capital Employed), Net Present Value and Internal Rate of Return.

These may be defined as follows:

Payback is the simplest and easiest technique and involves estimating the time taken for an investment to be paid for. Because it ignores returns made and costs incurred after the payback period, as well as the time-value of money (ie interest on money tied up, that could otherwise have been earned), it tends to favour projects that are characterised by the shortest period in payback terms

i) **Accounting Rate of Return/ROCE (Return on Capital Employed)** is a widely used method which estimates the total profitability of a project as a percentage of the cost of investment. It is a useful indicator of whether an investment is likely to offer a good margin of profit. The ROCE of a Purchasing project may be compared with the ROCE of the company as a whole; this will provide an indication as to whether or not the Business Case will have a negative or positive impact on the organisation’s overall level of profitability

ii) **Net Present Value** involves more complicated calculations which take into account the relative timings of cash flows. Purchasing projects generally tend to be long-term, so short payback is not quite so relevant; the NPV approach of discounting the value of future cash flows to their timing is an important element of the decision.

iii) **Internal Rate of Return** may be defined as the percentage a company would have to apply to an NPV calculation to get a zero return. Financial Controllers will have a "hurdle" rate that they expect all Business Case financial proposals to achieve. It is important therefore that before finalising his Business Case the author knows what these are and how his proposals are expected to perform

Accuracy in working out the above is essential, so it may well be prudent for the author(s) of the Business Case to have the calculations carried out (or at least checked) by the Finance Department.

The final thing to consider in the financial analysis of an Purchasing investment is to calculate the consequences of a 'do-nothing' approach – for example if a company decides not to invest in a website for sales they could well lose market share with possible long-term survival implications for the organisation as a whole.

Risks and Sensitivities

Comments are required on such risks as the possible influence of both internal and external factors on project performance or delivery, both in the short and long term.

A 'do-nothing' scenario could be included in this stage of the report because there is often no tangible or measurable cost attached to doing nothing but the Commercial considerations and the effect on the 'soft' issues (defined as aspects which cannot be measured accurately in terms of financial benefit) could be considerable. A rigorous debate of the issues relating to taking no action is another key to success – the expected objectives and benefits of the Business Case can be forcefully made in the description of the consequences of inaction.

Mention should also be made of the fact that a cost can usually be assigned to so-called 'soft' benefits

Other Options

This section is concerned with examining the effects of alternatives and other options, including a "do nothing" scenario.

A Business Case will be that much stronger as a consequence of a thorough consideration of the possible alternatives. The risk is that if the author of the business case has not seriously considered his options then the person(s) responsible for authorising (or not, as the case may be) the business case may ask this question when the proposal is first submitted. It is therefore much better to preempt the possibility of this situation arising and consider the alternatives up front. These could embrace a wide range of options including manual systems, joint venturing with a consortium, adopting an outsourcing approach, etc.

Implementation Issues

As is the case with Strategic Fit, implementation issues should be seen as being of key importance in securing the necessary funding.

The expected benefits of the proposal should be clearly stated, as should the various stages and timescales involved, and, not least, who will be in the implementation team.

Recommendation

It is at this stage, ideally, that the finance will be forthcoming.

As indicated in the Management Summary, the author(s) of the Business Case author would hopefully have secured the funding on the strength of the arguments to date, so it is at this point that the opportunity arises to not only confirm the requirement but also to present in detail what form the funding should take and over what timescale; this is also the appropriate time to describe the next steps, so that the recipient of the report is clear as to exactly what he is now required to do.

There is now an emerging trend for senior managers to wish to see the author of the business case to 'sing for his supper' – this will typically take the form of a discussion meeting with the writer and his team. Usually a presentation will be required; this should be seen not as a threat but rather as an opportunity to put forward the anticipated beneficial outcomes of the business case in a positive and persuasive fashion.

Case Studies

i) A Business Case for IT Systems and E Procurement

Purchase of a new IT system or implementing e procurement are two very common illustrations of the sort of business case which the Purchasing Dept may need to make. The two following cases illustrate the basic principles and approaches involved, placing emphasis on the expected benefits which the author of the business case will need to present to those holding the company purse-strings

Assessing the Business Benefits of IT Systems

Acquisition of IT inevitably involves expense, but this is not restricted to direct cost, it also takes a great commitment of time and effort to carry out a full assessment of the business requirements, and to map on to these the benefits which may be expected to follow.

An effective statement of business needs requires a wide understanding of the business, its processes, the supporting information flows, and future strategic plans. The business requirement specification must include implementation and operational needs. It is not always possible to fully specify the requirements in advance – a well-planned project should be able to take advantage of requirements and capabilities as they are discovered, provided that they are judged relevant to the core business objectives and do not increase risks disproportionately.

Consultation is needed not only with those intending to make use of the system, but also with those who originate the information being processed. It is important for acceptance of the system that the customers and users are committed to the analysis and resulting statement of their needs.

An effective analysis of requirements describes and investigates:

- Key business processes and the supporting information flows
- What the managers say they want, why, and its relevance to the business
- What the process and data owners say they need and why
- Usage of the data content and information flows
- Data and information that users will settle for – (a minimal set)
- Interaction between processes and the functional organisation
- Relevant acceptance criteria

Key Issues

- The focus should be on the anticipated business benefits, rather than on the technology
- IT projects should only be approved once it has been clearly established that they support the corporate business objectives
- Measures should be taken to ensure the support of senior management
- Appropriate resources for training should be put in place

- Projects should be reviewed on a regular basis to confirm that planned benefits are being realised

Action Required

The Board should ensure that the processes for planning delivery of identified business benefits include the following:

- Close alignment of the proposed IT investment plan with the organisation's business objectives
- Commitment to delivery of measurable business benefits within a timescale, and at a level of cost and risk that are realistic and appropriate to the business
- A shared understanding of the responsibilities for delivery of the project between system users and the IT specialists
- A plan to benchmark the performance of existing processes in business terms and to monitor improvements

The Board should appoint a business manager responsible for delivering the business benefits and a project manager responsible for delivering the system. These managers should be held responsible to the Board for the success of the project, and should be given the necessary authority to ensure this success.

In organisations with an ongoing IT investment programme, the Board should ensure that these processes are being systematically planned, executed, reviewed and improved within the organisation's quality management system.

Understanding how IT is able to deliver business benefits

Planned investment in IT must provide tangible and quantifiable advantages, which increasingly include reduced costs and/or improved levels of customer service. It is important to understand however that these business benefits will be derived from the exploitation, not just the implementation, of IT. This exploitation will only materialise if the IT investment programme is driven by business strategy.

ii) EProcurement

The author of a business case for e-Procurement should always bear in mind that this relatively new approach to purchasing needs to be seen in the context of an effective procurement strategy; it is also important to remember that the purchasing department needs to be sufficiently developed to implement e-Procurement. It is usually regarded as stage one of the multi-stage sequence, following the adoption and implementation of strategic sourcing, for the first time bringing about enterprise level visibility of all purchasing at little cost. It creates the opportunity for effective end-user relationship with suppliers under centralised control. These, clearly, are some of the anticipated benefits which the author of the business case will wish to highlight.

It is emphasised that e-Procurement should not be implemented as a stand-alone project within the purchasing department, but in conjunction with other initiatives which may be in progress. For example, if an organisation aims to introduce eRequisition tools and catalogues for the IT consumables category, it should first perform a strategic sourcing project on this category to ensure it has a sound commercial agreement, covering all its needs, with a supplier fully able to take part in its eProcurement initiative.

The business case should also demonstrate the disadvantages of not adopting eProcurement. Two examples are as follows:

- Implementing catalogues that do not provide sufficient coverage of a category and hence do not generate large transaction volumes or savings
- Implementing catalogues from several suppliers for one category, when the suppliers should have been rationalised. This will increase costs and reduce the potential for making worthwhile savings.

Why invest in eProcurement?

Those in the organisation responsible for evaluating the business case will be aware that in times of economic uncertainty and slow-growing revenues, reducing the cost base of an organisation is the single measure that can best improve the bottom line. For a typical company, a 5% reduction in purchasing cost can increase the bottom line as much as a 30% increase in sales.

The author of the business case will wish to make the point that eProcurement is often perceived as the least risky eBusiness initiative: the quantified benefits of eProcurement are well-documented and it can be piloted in non-competitive areas of the business, where the commercial consequences of conducting unsuccessful trials are minimal.

The e-enablement of purchasing activities often starts with transacting low value, high volume non-strategic goods and services that support the business – variously described as 'Indirects', 'MRO' (maintenance, repair and operations), or 'NPR' (non-production related). The main benefits of e-Purchasing lie in reduced transaction costs and better compliance with pre-negotiated contracts. Also many organisations – and increasingly government bodies – are turning to online auctions and online sourcing to negotiate and buy online a wide range of goods, often including IT hardware and consumables.

The procurement of non-production goods and services is seldom automated and controlled effectively. EProcurement of these indirect supplies provides a quick, low-risk opportunity to deliver eCommerce capabilities into the business, improve service to end-users and save money – savings which go straight to the bottom line and recur year on year. eProcurement, however, is more than enabling a purchasing relationship with low-value suppliers.

How does a company achieve the Return on Investment?

Early adopters of e-Procurement, including Reuters, CISCO, HP, Visa, Phillips and Honeywell, claimed savings on their 'indirect' spend of between 8 and 15%. Benchmark studies and research were also undertaken by organisations such as NAPM (North American Purchasing Managers Association), Gartner, and Forrester, all of whom have endorsed these claims as being achievable.

More recently however there has been a shift towards more realistic ROI figures and payback timescales. These recognise that organisations which have already introduced strategic sourcing will have taken out some of the cost saving benefits available. It has been estimated that realistic annual savings from initial e-Procurement projects are roughly twice the investment costs but that, due to ramp-up times for the savings, payback timescales may be longer than a year.

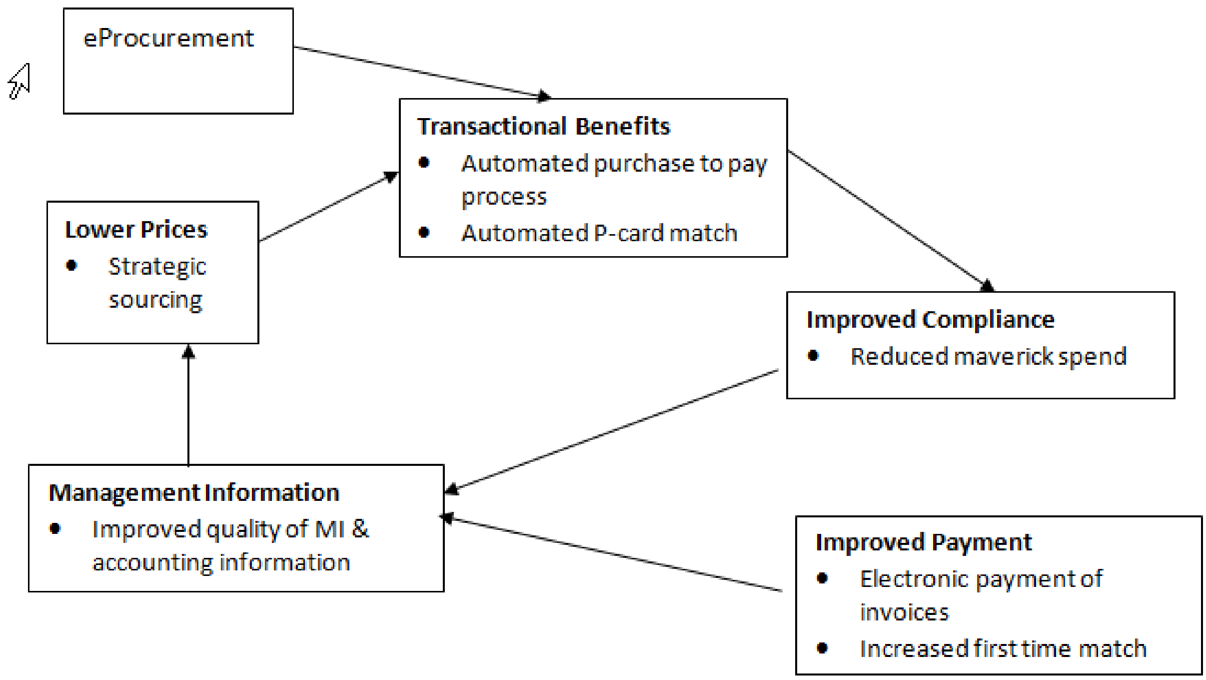
There are two sources of tangible benefit achievable from e-Procurement:

- Reduction in **purchase price** – direct delivery of savings to the bottom line. Implementing a transaction e-Purchasing tool will not in itself reduce the price paid to suppliers for goods and services. Through an increase in contract compliance (users buying from pre-negotiated supplier contracts rather than locally) the overall price paid for goods and services should decrease. E-Sourcing applications support commercial negotiation processes with suppliers to improve supply conditions and price.

- Reduction in **process costs** – more effective use of time, which can be translated into financial benefit if effectively managed and measured.

There are also intangible benefits, such as cultural change and enabling e-Business into the organisation which are not easy to measure but may be a motivation to introduce e-Procurement. It is important not to misclassify 'soft' but measurable benefits as intangible, just because measurement may be more difficult.

These benefits are interdependent, as illustrated:



The author of the business case will need to be aware that introducing e-Procurement is however, not always straightforward, involving as it does major changes, often apparently running counter to the corporate culture, which in most organisations is to empower local business units. Care will be needed to manage the 'soft' aspects including:

- Need for visible executive sponsorship
- Motivating end-users to adopt the new systems
- Re-engineering internal processes and dealing with cross-company cultural differences, and
- Care needs to be exercised to avoid being seduced by the technology.

Source: 'BuyIT e-Procurement Best Practice Guideline'

Conclusion

Although this 'How To' has emphasised the importance of thorough and rigorous preparation in drawing up and presenting a business case, it occasionally happens that a business case will need to be based on a more `intuitive' sense of the benefits that the proposal might provide, as the concepts involved in the proposal may be so new to market they may be difficult or impossible to quantify or evaluate as was the position for example, in some of the early eProcurement business cases.

CIPS KNOWLEDGE

CIPS Group Easton House, Easton on the Hill, Stamford, Lincolnshire, PE9 3NZ, United Kingdom
T +44 (0)1780 756777 F +44 (0)1780 751610 E info@cips.org

CIPS Africa Ground Floor, Building B, 48 Sovereign Drive, Route 21 Corporate Park, Irene X30, Centurion, Pretoria, South Africa
T +27 (0)12 345 6177 F +27 (0)12 345 3309 E infosa@cips.org.za

CIPS Australasia Level 8, 520 Collins Street, Melbourne, Victoria 3000, Australia
T 1300 765 142/+61 (0)3 9629 6000 F 1300 765 143/+61 (0)3 9620 5488 E info@cipsa.com.au

CIPS Middle East & North Africa Office 1703, The Fairmont Hotel, Sheikh Zayed Road, PO Box 49042, Dubai, United Arab Emirates
T +971 (0)4 327 7348 F +971 (0)4 332 5541 E mena.enquiries@cips.org