

Teach Yourself: Economic Evaluation:

3a. Decision Making Making the Decision

Spend only a few seconds on most slides.

Economic evaluation has three levels ...

Level 3: Decision making

Level 2: Evaluating the business/project

Level 1: Hands-on economic modelling

The purpose of this module is to...

Level 3: Decision making

Level 2: Evaluating the **make the decision in**

full knowledge with

'eyes wide open'

Level 1: Hands-on **economic modelling**

Making the final decision

The final decision should be based on:

1. a basket of economic measures

Making the final decision

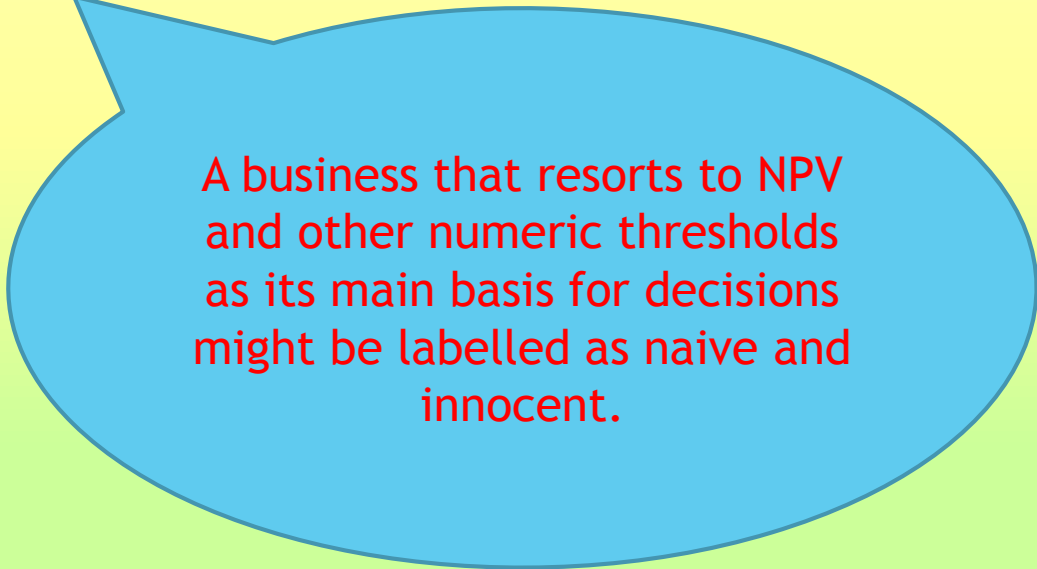
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2. → using judgement!

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A business that resorts to NPV and other numeric thresholds as its main basis for decisions might be labelled as naive and innocent.

1. A basket of measures ...

All the evaluation work done at Level 2 needs to be brought together so the decision makers have ‘eyes wide open’.

- ▶ They need to understand the total picture of
 1. their industry,
 2. their business inside that industry and
 3. their project inside their business.

- ▶ You need to present them with a comprehensive but succinct ‘helicopter view’ with the most important items first
 1. A conclusion/recommendation probably should be first
 2. followed by the key results (both positive and negative)
 3. the most important issues
 4. the lesser issues
 5. And give them access to the detail in any area they may wish to more fully understand.
 - (avoid the boring format of technical reports with Introduction, Method, Discussion, Results, Conclusions, Recommendations)

1. A basket of measures ...

The basket of economic measures could include:

1. NPV, IRR, Payback
2. The full range of possible outcomes with risk weightings
3. The economic health of the underlying business, regardless of ownership
4. The outcomes for each entity in a joint venture
5. The outcomes for other stakeholders, such as government, community, minorities
6. Key parameters/assumptions and their impacts/risks
7. The flexibility of the project to be able to adapt to severe improvements and severe deteriorations in business conditions and to the resource,
8. Minimum prices to avoid bleeding cash compared with history and forecasts
9. Optionality if the project proceeds and does not proceed - probability weighted
10. Position on the industry cost curves
11. Competitive advantages and competitive weakness of the project/business
12. Status of the industry - maturity, relative strengths of sellers/buyers

2. Using judgement ...

This comprehensive but succinct view of the project/business/industry will provide a sound basis for a decision. But final decision makers need more - they need “judgement”.

Too many bad decisions have been made by high-powered senior management and well-positioned Boards of major global companies. They have seen all the economic metrics but not delved deeply enough to educate themselves on the critical assumptions. They have wanted to go along with the decision because the ‘experts’ have shown it is good!

Decision makers need to have ‘wisdom’. They should have sound experience in the industry, maturity in the business, detached critical thinking, independent advice and their own objective evaluation.

- ▶ The decision makers need to fully understand all the evaluation results, the critical underlying assumptions, the limits of the assessments, the strengths and weaknesses of the evaluation.
- ▶ Should they be investing in that industry? In that business? In that project?
- ▶ Is there a better way of fruitfully exploiting this opportunity?

Too many bad decisions...

- ▶ There are countless bad decisions that have been motivated by people wanting to satisfy their own ego's or key performance indicators (kpi's) to earn a bonus.
- ▶ Occasionally the management and Board of a major company will make a deliberate, huge, poor investment solely to make themselves less attractive for take-over and so preserve their own jobs.
- ▶ Many of us can confess to becoming emotionally involved in a project or business from its beginnings and where we want it to proceed to become a personal achievement
- ▶ Too many Boards have been misled by the company's management to make a decision that satisfies the ego of the CEO.
- ▶ Lots of CEO's have had 'high conviction' about a pet project and hammered the Board into a poor investment that has been dressed up to look good.
- ▶ Some senior managers have employed an independent peer review to re-assure the Board, but picked experts who were compliant and then controlled the review activities.

Sometimes a very successful decision ...

- ▶ Deciding against a recommended investment or project can be very sound

“Eyes Wide Open”

For anyone to find and develop a project or business that can be shaped and grown into a successful investment is a major accomplishment!

- ▶ It is much easier to kill a project/business than to toil and innovate to make it work.
- ▶ Making a decision on a borderline investment is hard!
- ▶ We must admire people who work through adversity and overcome popular opinion and then go on to make a project/business succeed.

Your role is to make sure the decision makers know everything important so they can make their decision in full knowledge - with ‘eyes wide open’