Why a Business Case for Investment?
Our lives teem with numbers, but we sometimes forget that numbers are only tools. They have no soul; they may indeed become fetishes. Many of our most critical decisions are made by computers, contraptions that devour numbers like voracious monsters and insist on being nourished with ever-greater quantities of digits to crunch, digest, and spew back.

P Bernstein, Against the Gods (1996, p. 7)

The difficulty lies, not in the new ideas, but in escaping from the old ones.

John Maynard Keynes, The general Theory of Employment, Interest and Money (1964)

1.1 Introduction

A new approach to develop a business case for investment which will directly help the organisation produce improved results is long overdue. But before embarking on a detailed discussion of how business case for investment may be used to optimise returns on investment it is important to make clear what is meant by investment. The word investment is used in business in a number of different senses. The owners of the business had to invest in order to bring about the existence of the business. They had to supply some share capital and perhaps some loans. The money required to do this is referred to as investment and this is what this book is about. Sometimes a business may purchase shares in another business and this is referred to as investing in the other business. This book does not deal with the evaluation of such purchases, although many of the techniques used in these two activities have a lot in common.

The money spent by the business to acquire the assets which the business needs to function is also referred to as investment. These assets may consist of land and buildings, factories, machinery and equipment, information and communications technology systems, vehicles of all sizes etc. In general when money is spent on fixed assets we speak of the outlay for these

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1 Research suggests than more than 50% of all funds invested by organisations is spent on information and communications technology systems.
items as being investments in the business. There are other
assets in which an organisation has to spend its resources on
including inventories, debtors, prepaid expenses etc. These
items are referred to as current assets and they also require
investment. Current assets are also referred to as working
capital.\(^2\) Finally there are intangible investments which
include items such as trademarks, copyrights and goodwill
and funds may be required for these. It is sometimes difficult to
value these intangible assets but it is worth mentioning that
the value of goodwill is the difference between the net asset
value of a business and the price which was paid for it. Thus if
goodwill appears in the accounts of a business it means that
another business has been previously purchased. An organ-
isation’s typical asset profile is shown in Figure 1.1.

Investment money needs to be contrasted with current
expenditure. We pay monthly or weekly salaries or wages.
This is not investment but expenses or disbursements. The
same would be said of all other business costs which are used
up at the time they are paid for.

It is important to give at least one example of the misuse of the
word investment. Sometimes it is said that sending staff on
a course is investing in them and the company’s future.
Strictly speaking this is not an investment but rather an
expense – using the word investment sounds better and gives

\(^2\) The strict definition of working capital is current assets less current liabilities.
the impression that the benefit is intended to last some time.³

Some organisations talk about their having an investment cycle. The cycle refers to the process of identifying an investment opportunity, developing a business case, spending the money, making sure that the investment works and reporting on the success (or failure) of the investment. This book limits itself to how to evaluate a proposed investment in fixed assets and any expansion in the current assets which might accompany an increase in fixed assets.

Historically, organisations have frequently not bothered to produce a business case or if they have, they have tended to cobble together some financial figures based on a combination of historical records and/or semi-valid assumptions and estimates. Sometimes organisations have produced so-called cost-benefit analysis or even feasibility studies in the form of rather simplistic financial generalisations about paybacks and return on investment⁴ that have not looked carefully at the business issues involved with or behind the actual investment. On the other hand these cost-benefit analysis or feasibility studies have sometimes led to confusion and redundant effort which was clearly demonstrated by Drucker when he said:

_We have known for a long time that there is no one right way to analyse a proposed capital investment. To understand it we need at least six analyses: the expected rate of return: the payout period and the investment’s expected productive life: the discounted present value of all returns through the productive lifetime of the investment: the risk in not making the investment or deferring it: the cost and risk in case of failure: and finally the opportunity cost._ (Drucker, 1988)

³ This is not a book on accounting so I will not venture into the grey area between business expenses and business investment. Suffice it to say that the rules for declaring an item an investment as opposed to an expense and vice versa are open to a degree of interpretation.

⁴ Both payback and return on investment are critical issues in a comprehensive business case where they are supported by other detailed considerations. Chapter 9 will examine these ratios in some detail.
Cost-benefit analysis, which may be defined as a financial statement reflecting the expected expenditure and the possible quantifiable benefits, does not on its own constitute a complete or comprehensive, or a properly rigorous business case. Cost-benefit analysis is typically only a relatively small part of a bigger story, and Fig. 1.2 shows what might be considered as the relative significance of cost-benefit analysis in a comprehensively produced business case.

The comprehensively produced business case is a greater piece of work than the relatively superficial cost-benefit analysis.

Besides cost-benefit analysis a comprehensively produced business case needs to consider a number of other issues such as the stakeholders, the strategic alignment potential of the investment, the technology involved and the various risks associated with the project. Just gathering financial estimates is simply not enough in the twenty-first century. The reason for this has been well summarised by Laudon in the information and communication technology context when he said:

*Building an information system, ... an online, distributed, integrated customer service system, ... is generally not an exercise in ‘rationality’. It is a statement of war or at the very least a threat to all interests that are in any way involved with customer service.* (Laudon, 1989)

Thus a traditional cost-benefit analysis in a feasibility study is simply not adequate or rigorous enough for an appropriate

![Figure 1.2 Cost-benefit analysis as a sub-set of the business case](image-url)
understanding of the important issues involved in an investment which may go to the heart of the business.\(^5\)

This traditional lack of rigour in business case development has occurred because it has been thought that the key business issues do not easily lend themselves to proper business analysis, let alone sensible financial quantification. This pessimistic view is not as eccentric as it might first sound. It is supported by no less a personage than John Maynard Keynes who is still regarded by many as being one of the greatest economists on the twentieth century. Keynes pointed out as far back as 1936 that the analysis of future business investment was extremely difficult, when he said:

_We are merely reminding ourselves that human decision affecting the future, whether personal or political or economic, cannot depend on strict mathematical expectations, since the basis for making such calculations does not exist; and that it is our innate urge to activity which makes the wheels go round, our rational selves choosing between the alternatives as best we are able, calculating where we can, but often falling back for our motive or whim or sentiment or chance._ (Keynes 1964)

He went on to say:

_Our knowledge of the factors which will govern the yield of an investment some years hence is usually very slight and often negligible. If we speak frankly, we have to admit that our basis of knowledge for estimating the yield ten years hence ... amounts to little and sometimes to nothing; or even five years hence._ (Keynes, 1964)

There are of course those who would say that the comment of Keynes should have referred to three years hence or even one year hence. This remark goes some way to explain why cost-benefit analysis for investments sometimes has so little credibility and why it is sometimes simply seen as satisfying capital budgeting bureaucratic requirements.

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\(^5\) Of course not all investments are of this type. But increasingly organisations want to find investment opportunities that will deliver the type of competitive advantage potential referred to here.
Despite Keynes’ comments, financial quantification of the costs and benefits related to an investment, even when imperfectly estimated, are useful to managers and to the business. But it is important to understand that they are always only part of the greater overall picture. By the way there is a range of approaches to cost-benefit analysis and it is important to comment on the impact of Zero Based Budgeting techniques. Some organisations when creating a set of financial figures for an investment will extract the figures used last time and adjust them for inflation and business growth. This approach is sometimes called the traditional approach to budgeting and there are numerous reasons why this is a flawed approach. The Zero Based Budgeting approach is not simply based on adjusted historical figures but on current estimates of costs and benefits. But the issue here is that estimates of costs and benefits for capital investment are only part of the picture.

One of the recurring criticisms of the traditional approach, or even a Zero Based approach, to cost-benefit analysis has been that it was too easy to produce cost-benefit numbers that were based on unsafe assumptions. Thus although a cost-benefit statement may include an impressive array of numbers which purport to represent all the appropriate cost items required to build a new factory, they could be based on totally unfounded guesses or questionable assumptions. This is an even greater problem when it comes to the estimation of the improved benefits from the investment. Because of the fact that some cost-benefit statements have been based on questionable assumptions their credibility has frequently been put in question. Managers, who can sometimes be quite cynical, just do not believe the estimates that are sometimes produced, and this has led to the problem of obtaining the appropriate level of stakeholder commitment. And it is often said that the appropriate level of stakeholder commitment is the single most important factor towards ensuring the success of any investment project.

1.2 The comprehensive business case

A comprehensive investment business case involves a process which looks beyond financial estimates to the central business
issues concerning the processes and practices that are the fundamental reasons why organisations invest. This does not imply that financial estimates are not frequently of critical importance, but because of their inability to capture certain issues, financial figures alone are not sufficient for a full business justification of an investment. At the same time it is important to understand that the estimates, financial and others, which are used for investment evaluation, are always opinions about the future and are thus often not as accurate as is suggested or thought.

Furthermore the traditional approaches to understand the nature of the costs and the benefits of an investment have usually missed an important opportunity, because a well-constructed business case or investment proposal is an important tool in the process of managing the investment itself. As investments have become increasingly more sophisticated, and as they increasingly require larger and larger amounts of funds, it is important that a comprehensive and professional approach to developing business cases be employed.

1.3 A business case as a model

A business case for an investment is a model of what the organisation expects to be able to achieve when it uses the investment to support improvements in its process and practices. It is a sophisticated model which is produced to facilitate decision making and to help in this respect with what-if questions.

The business case model may be created at different levels. A high-level or macro-model may be produced which addresses general issues at a high level. The purpose of the macro-model

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6 The word model is used to describe a wide range of different things. A model may be a representation of an artefact, a construction, a system or an event or sequence of events. The representation may be abstracted into symbols, equations and numbers, i.e. mathematical expectations; it may consist of a picture or a drawing, or a fabricated likeness such as a model aeroplane, or it may be an expression of a situation or relationship in words.
is to present a conceptual picture which will contextualise the problem or opportunity which the organisation faces as well as provide a suggested solution. An intermediate or meso-level model adds some detail, and will also express the dimensions of the problem and proposed solution, but will still be expressed primarily in generalities. A detailed or micro-level model attempts to be closer to the actual activities which will be required and thus to use specific values. The primary purpose of the micro-model is to understand the detailed impact of the proposed investment. However, all the models are by their nature simplifications of the reality which they represent. In fact sometimes the simpler the model the more useful it may be. Complex models may actually cloud the central nature of the issues being studied and thus reduce the explanatory power and consequently the value of the model.

1.4 Definition of a business case

A business case is a justification for pursuing a course of action in an organisational context to meet the stated organisational objectives or goals. A business case frequently involves assessing the value of an investment in terms of its potential benefits and the resources required to set it up and to sustain it, i.e. its on-going costs. One of the major difficulties in producing a business case is the fact that the benefits of an investment are often a function of the values of the organisation and the executives who are making the investment decisions. Thus a business case will inevitably have a significant degree of subjectivity associated with it. It is because of this potential to view the business issues subjectively through the eyes of the agendas of the different business groups involved that the individual developing the business case needs to be as objective as possible and strive for consensus among the stakeholders.

1.4.1 Components of an IT business case

A professionally produced business case or investment proposal consists of:
(1) A clearly expressed business objective and set of outcomes. These high-level business outcomes need to be comprehensively expressed as a set of opportunities the organisation can take advantage of, or problems that need to be rectified; a list of specific and detailed benefits, their appropriate metrics, measuring methods and responsibility points represented by particular stakeholders, and a justification that the proposed plan will produce an acceptable organisational return. This involves the quantification, the contribution made by the outcomes, which requires associating financial numbers or benefit values with outcomes wherever possible;

(2) A list of stakeholders and beneficiaries of the investment;

(3) A statement of how the proposed investment will support the corporate strategy;

(4) An evaluation of the appropriateness of any technology to be used;

(5) An evaluation of the risks associated with the investment.

To be of value to an organisation the business case should be expressed in terms of identifiable or quantifiable objectives and actions. Thus it should start with the big picture of what will be achieved by the investment. It should be a multi-dimensional high-level picture of the intentions of the investment. Then a detailed drill-down exercise is needed to establish the precise outcomes, which can be seen in Fig. 1.3. These should be highlighted and expressed in such a way that they can be controlled by appropriate stakeholders, and that it

Figure 1.3 The multi-dimensional high-level picture is then drilled-down for detail
can be ascertained if these outcomes have actually been realised. Chapter 4 shows how this may be done by using a macro-, meso- and micro-model. Thus the business case is a cornerstone of the process of ensuring value-for-money investments.

In the final analysis a comprehensively produced business case is as much a plan as a justification. It is worth noting that very often a business case can only be formally produced after a considerable amount of initial work with stakeholders and process analysts has already been done. Thus the business case is not the first step in the process of introducing a new information system.

1.5 Corporate culture is central to a business case

It is critical to note that the approach to be taken in developing a business case is particular to each organisation, and its specific corporate culture. Consequently there is no uniquely correct approach nor is it possible to produce a template which will satisfy all or even most organisations. Despite this there are some helpful checklists discussed in this book. Copies are supplied in the appendices.

Corporate culture is central and is the determinant of the format of the business case. Possible approaches vary considerably and they differ in terms of the input to the business case, how the business case is calculated and processed within the organisation and the sort of results that are obtained. Corporate culture will also determine if the business case will be used as a management control device after the investment is made.

Some organisations require strong emphasis on detailed financial projections, while others believe that summary of financial figures is more than adequate. Some organisations are more interested in descriptions of how their new investment will change the way things are done and do not necessarily require these benefits to be quantified in detail.

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7 In fact some corporate cultures will simply not require the production of a business case.
In some organisations top management determines the structure of the business case and it is handed down for more junior staff to action. In other cases the business case is essentially a bottom-up event where the individuals who will actually do the work will create the business case.

However whatever the particular culture the law of parsimony, sometimes known as *Occam’s razor*, is always an important issue, i.e. a 20-page business case can be substantially more effective than a 200-page treatise. Also the business case should not take weeks or months to develop, nor should it cost a material proportion of the amount to be invested.

### 1.6 A caution

Before ending this section it would be remiss of us if we did not point out that the benefits of a business case (sometimes referred to as a business plan) may be exaggerated. One of the clearest examples of this exaggeration may be found on the website


where it is said that:

> By the time you have finished writing your Business Plan (the word case and plan could be interchanged here) you will have a total understanding of your business; its strengths and weaknesses, the environment it operates in, what could potentially go wrong, and what you can do to ensure your success.

There is no doubt that having a comprehensively developed business case or business plan is of considerable value but it also needs to be realised that planning is one thing and the execution of the plan is quite a different matter. This thought has been addressed a number of times in literature including

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8 William of Occam (c. 1285–1349), a notable English monk, scholar and philosopher and theologian coined the expression, which translates into English as “It is vain to do with more what may be done with less”. The twentieth century equivalent of this is the KIS principle, which means Keep It Simple.
the famous book Of Men and Mice by Nobel Laureate John Steinbeck who said “The best-laid plans of mice and men often go awry”. Steinbeck had borrowed this thought from Robert Burns whose version of this thought was “The best laid schemes o’ mice an’ men, Gang aft agley”. In twenty-first century language this could be translated into Planners Beware.

1.7 Who owns the business case?

A question which is frequently raised is Who owns the business case? This is an important issue which needs to be addressed at an early stage in the business case process. Organisations do not expend large sums of money on fixed assets unless there is good reason for doing so. In order to make sure that such funds are not spent inappropriately, investments require a sponsor who is normally a senior member of the organisation’s executive team. The sponsor motivates the investment and becomes involved in the preparation of the business case. However it is highly unusual for a sponsor to become involved in the commissioning or even the operation of the investment. Once the investment business case has been approved then the work in bringing the investment into life is usually undertaken by a project management team. When the work of the project management team is finalised and the investment is commissioned, the organisation will normally appoint an investment champion. The role the investment champion is to ensure that the implementation works according to plan and that the ongoing costs are kept under control and that the ongoing benefits are realised.

Thus it may be seen that in a sense the business case will be owned by a number of different people at different stages in the creation and the operation of the investment. In the early stages the investment sponsor may be regarded as owning the business case. During the development phase the project manager becomes the owner of the business case. Once the project has been completed and is up and running then someone whom we referred to as the champion will take over and own a business case. Finally when the project has been well-bedded into the
organisation and its operation has become routine, a departmental head will normally own the investment. As investments are frequently audited – performance against projected costs and benefits the departmental head could be seen as the owner of the ongoing business case.

1.8 Summary

The current importance that is being attributed to the business case rests on the fact that investment evaluation is seen as a key strategy by which investment management can be improved. The main issues to which a comprehensively produced business case can contribute include:

(1) Facilitating the creation of corporate knowledge and learning in terms of what is really expected from the investment and how to manage the development project better in order to achieve its objectives; this includes a full assessment of the viability of the investment project;

(2) An opportunity to acquire the full commitment of the principal stakeholders who will have to play a part in ensuring the success of the investment; this includes creating a framework for stakeholder management which is central to ensuring that when the investment is commissioned there will be no surprises for any of the major stakeholders;

(3) Understanding the risks involved in making the investment deliver the anticipated benefits; this includes putting into place any necessary precautions to reduce the risk or to counter its effects if it actually materialises.

If these three objectives are achieved then the investment in producing the business case will have more than paid off. Thus a business case represents a new way of thinking about investment, which is a major step in the professionalisation of corporate investment management.