A Value Management Approach to Strategy

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Abstract

This paper examines how a value management approach can be applied to organisational strategy. The value management concept of challenging current wisdom, looking at fresh ideas, assessing their feasibility and evaluating the costs and benefits of various options, provides a rational approach to reinvigorating an organisation with a performance that lacks lustre. There are examples that indicate the great benefits of using the value approach. The practical implementation of strategic value management relies on appraising every aspect of business functions, processes and objectives, using the value management approach. Strategic value management should lead to a rapid reinvigoration of an organisation.

1 Introduction

It is the goal of almost every privately owned company to increase profitability. There are essentially two mechanisms for achieving this: reducing the cost base and increasing revenue. Ideally companies would like to take measures that achieve both simultaneously. Most organisations can find ways to cut costs. It is often more difficult to increase revenue. Unfortunately, cutting costs in the short term often results in a reduction in revenue earning ability in the longer term. In the same manner, a drive to increase revenue in the longer term often results in an increase in costs in the short term. The conjuring trick, which few ever manage to achieve, is to identify both the areas of large cost that make little or no contribution to business performance and the prospects for opportunity that are worth funding.

Because the conjuring trick is difficult to perform and requires an innovative insight, most organisations resort to what they regard as easy wins. This approach is founded in the belief that the people working at the point of delivery are responsible for wasting resources and can be encouraged to produce more revenue. The result of this is often a permanent effort to drive down costs by reducing what those at the centre of the organisation consider to be waste. In the short term, this often produces savings sufficient to satisfy the immediate demand. However, not only is this approach fraught with danger in the longer term, but also it actually diverts attention away from the real problem. These two issues will be dealt with separately.

2 The Spiral of Decline

Short-term, point-of-delivery cost savings are usually a hollow victory. They result in two very real effects. The first is that those who work at the point of delivery find it harder to carry out their work. This means that they become less able to deliver the increased revenue sought by those who demanded the cost savings. Unfortunately, there are consequential effects of this. The first is that the point point-of-delivery people quickly become demoralised. Often, the good ones leave (or are driven out because they will not meekly accept what they see to be foolish constraints). Of those who are left, many are of mediocre calibre in terms of ability to generate revenue and increase customer satisfaction. The second is that, having achieved the desired saving one year, the organisation is tempted to adopt the same policy in subsequent years when faced with a potential shortfall in profit. The net effect of this style of cost cutting is that the organisation gradually decreases its ability to generate revenue, resulting in a further need for cost cutting. This is often known as the spiral of decline. It is in sharp contrast to the dynamic, expenditure-led expansion of companies that are seriously developing markets and market share.

When an organisation enters the spiral of decline, it becomes further and further separated from its goals and vision. It fails to respond to, or even recognise, market trends. As a result it is overtaken by what Johnson [1] describes as strategic drift. Strategic drift occurs when an organisation gradually loses touch with the incremental changes in the business environment and only realises that it has lost touch when it is too far removed to be able to retrieve the situation by incremental change. The result is that it tries to apply radical methods, which result in wilder and wilder oscillations. Eventually a point is reached where a turn-round specialist is required to carry out the actions necessary to put the organisation back on course (see Figure 1). Of course a successful turn-round cannot be guaranteed.

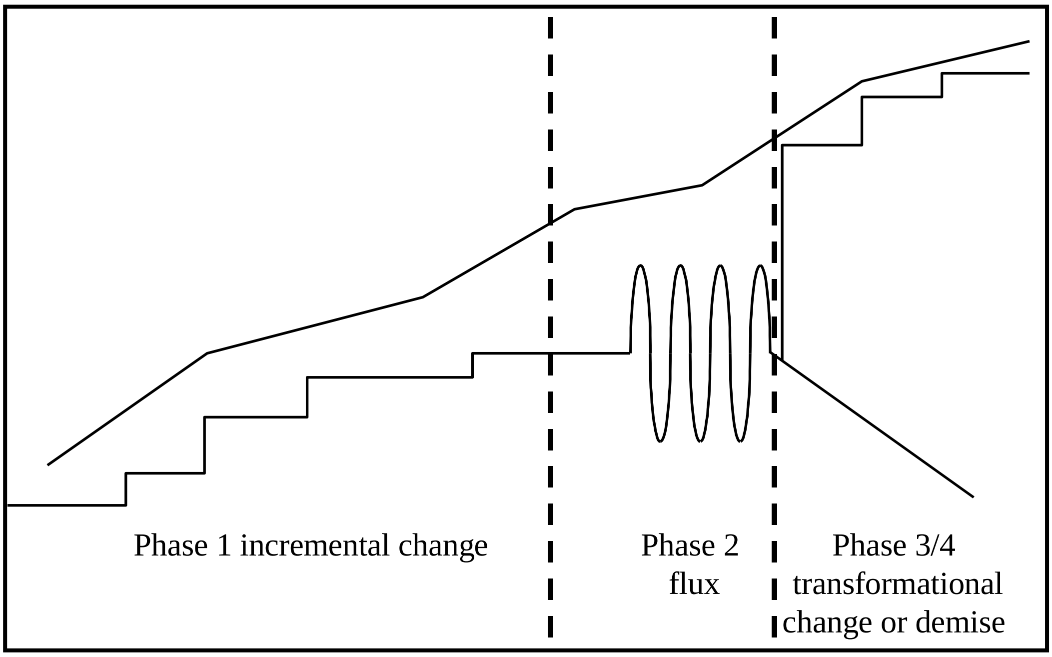

Figure 1: The risk of strategic drift [1]

Johnson's figure indicates two distinct types of management strategy. During strategic incrementalism, the strategy is essentially one of "steady as she goes". However, in a turn-round situation, the strategic change must be drastic and the timescale short, typically of the order of three months. Anyone who has ever used modern simulation software to investigate a turn-round scenario will be aware of the enormous difference between the two strategies. If the action is not sufficiently drastic, or if the timescale is too long, the spiral of decline will set in again, leading eventually to demise.

3 The Real Problem

The real problem involves identifying what the real costs are and where value is added. For example, unless people are not paid for time not spent on fee-earning activities, salaries are a sunk cost. Therefore, trying to reduce overhead spend by reducing time bookings to overhead numbers has no impact on costs. If point-of-delivery people are under-employed on fee earning work, the only way to improve the situation is to either make some redundant or, more plausibly, increase sales. On the other hand, closing down parts of the organisation that add little value to operational activities has great potential to genuinely reduce costs. What we have just described is based on the principles of value management. The purpose of the value management approach is to continually challenge current beliefs and practices until the real value issues have been identified and the value equation maximised.

3.1 THE VALUE MANAGEMENT APPROACH

In a value management context, value is defined by the equation:

$$\textbf{Value} = \frac{\textbf{Benefits to she or he who pays}}{\textbf{Cost to she or he who pays}}$$

For an organisation in business with the objective of making money, the ultimate benefit is revenue. However, there may be intermediate benefits, such as customer satisfaction, image and reputation, market differentiation, technical excellence or simply being an enjoyable and desirable place to work. The value management approach is characterised by a value workshop. The value workshop aims to identify any activity that could be added or eliminated, with the potential to increase value. This is initiated by a functional analysis activity, known as FAST (Functional Analysis System Technique). FAST begins by asking what is the function of something (in this case the organisation), *i.e.* what does it do? It then repeatedly asks two questions: “How?” and “Why?”. “Why?” cascades upward towards the root motivation while “How?” cascades downward towards basic activities. The result is a rather complex matrix of activities and motivations. A simple example of a FAST analysis is shown in Figure 2.

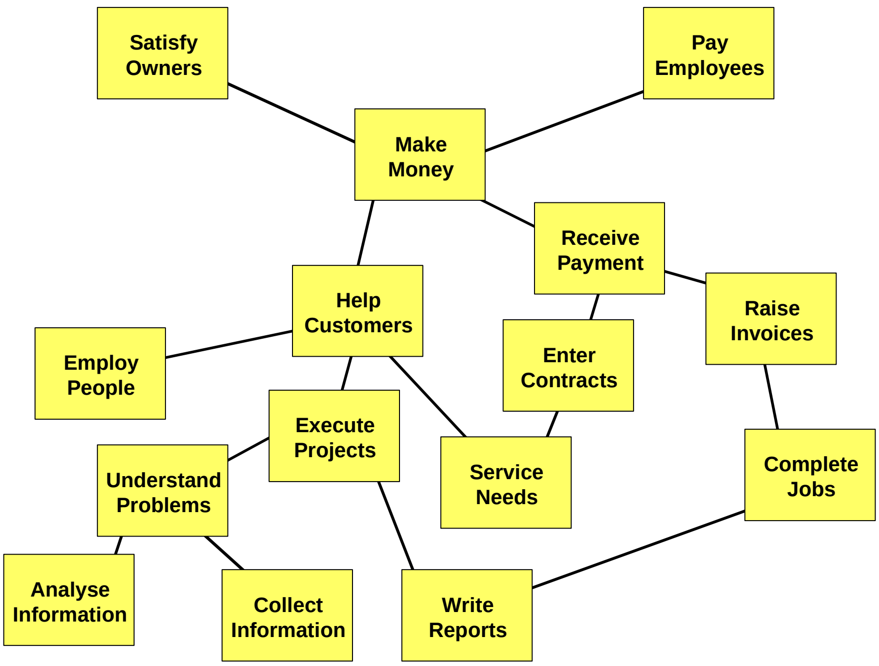

Figure 2: Example of FAST output

FAST is followed by a brainstorming session that can be expected to generate between one hundred and two hundred ideas in about an hour. The ideas are then classified into one of four groups:

- Easily implemented;
- Less easily implemented;
- Implementation requires investigation;
- Implementation unlikely to be feasible.

The ideas are then grouped and evaluated to determine the benefits and costs associated with each. Although the value management approach is often intended for project design, it is equally valid in the context of organisational strategy.

3.2 VALUE MANAGEMENT AND STRATEGY

Although it may not be appropriate to use the value workshop approach to strategic value management, the steps are essentially the same. After the FAST activity, the next step would be to identify the different component parts of the organisation and decide what benefits accrue from each and what costs are attributable to each. The key questions that need to be addressed include:

- Do the functions add real value?
- Could the functions be easily carried out by another part of the organisation?
- Could the value of the functions be increased?
- What would happen if that part of the organisation ceased to exist?
- What additional functions would add value to the operational activities?

This type of approach makes many managers feel uncomfortable. They may prefer the familiar to the unknown. However, the approach is essential to turn a business that has been unremarkable in its performance over a number of years into a thrusting, dynamic one.

3.3 EXAMPLES OF STRATEGIC VALUE MANAGEMENT

When Bob Townsend took over Avis [2], it had not made a profit once in the thirteen years of its existence. He abolished six corporate divisions, including planning, marketing and personnel (or HR in today's parlance). In three years, the business doubled its turnover and made an increasing profit in each of those three years.

Ricardo Semler [3] reinvented his family business by applying a whole series of radical changes to it. In each case he appraised the value management issues (although he may not have realised it). Each change was in itself revolutionary and was implemented rapidly. In a Brazil characterised by political and economic turmoil, the businesses (for that is what the single business became) flourished.

The turn round of a restaurant chain with flagging sales, increasing competition and deteriorating assets depended on an approach which considered the value of the menu range, the state of the properties, the price of the meals and the loyalty of the customers. By a drastic short-term change in direction, the chain was quickly able to return to profitability and strategic incrementalism.

There are two types of manager: leaders and administrators. Most organisations employ administrator-managers. If an employee goes to the manager and says, “If I could have one of these new widgets I could make us a lot of money”, the leader-manager will reply, “OK. I’ll get you one”. What’s the model number and how much does it cost?” The implication is that real value will be added. On the other hand the administrator-manager will reply, “OK, write me a business case and I will submit it to my boss and she will submit it to a committee.” By the time the reply comes back, if ever, it will be either too late or the employee will have become de-motivated (or have moved on). When organisations change from being ordinary to become dynamic, the managers change from administrators to leaders. In organisations with several tiers of management (whether officially recognised or not) the value management approach queries the value of each tier. When every manager and employee understands his or her own value, the organisation will be in a position to really flourish.

4 Practical Application

Consider an organisation with the following chain of line management for its operational activities:

Managing Director	⇒	**Corporate Support**
⇓		
Director of Operations	⇒	**Corporate Support**
⇓		
Operational Directors	⇒	**Corporate Support**
⇓		
Department Managers	⇒	**Department Support**
⇓		
Location Managers	⇒	**Location Support**
⇓		
Project Directors	⇒	**Location Support**
⇓		
Project Managers	⇒	**Project Support**
⇓		
Point of Delivery		

The immediate questions that would arise are:

- What value do the Operational Directors add that the Director of Operations cannot?
- What value do the Department Managers add that the location managers cannot?
- Do Project Directors add value?
- Can the Location Managers fulfill the roles of the Project Directors?
- Could Location Support fulfill the role of Department Support?

Each of these would need to be addressed on the basis of the available options, the cost of each option and the benefits of each option. Often, a solution to one will affect another, so the options need to be considered as an entire package. This will carry over to the issues raised in the rest of this section.

Assuming that there are non-operational functions within the organisation, the following questions might arise:

- Can a single person fulfill the HR role, with people management devolved to managers and records managed by finance?
- Can the MD manage marketing in collusion with the other managers?
- Can the MD manage planning in collusion with the other managers?
- Should the project managers handle detailed sales activities?
- Should project managers handle proposal writing?
- Should contract negotiation be assigned to project managers?

The above issues should be addressed with respect to value. For example, when considering the functions of HR, we need to ask what benefits an HR function provides and whether this would be improved or reduced by a different solution.

In considering point-of-delivery performance and scope for operational improvement, the following questions need to be addressed:

- What value is there in assessing performance on an individual as opposed to a team as a whole?
- What is the value of trying to reduce overhead spending if this reduces the profit of fee-earning work?
- What are the value issues surrounding team members carrying out product or market development when there is no fee-earning work?
- Do value judgments encompass self-motivation and the effectiveness at the point of delivery?

The value management approach can also be used to consider the interface with the environment within which the organisation operates. Examples of questions that could be raised are:

- Do the market sectors in which we operate offer the best value?
- Are there new market sectors that offer increased value?
- Does our product portfolio offer the best value?
- Does current customer satisfaction give best value?
- Could an enhanced reputation increase value?
- Are there any market differentiators that could increase value?
- Would an improvement in technical excellence increase value?
- Would increasing the desirability of the organisation as a place to work increase value?

The strategic value process is not a lengthy one. A small team could address the majority of the issues within a single day. Any outstanding technical queries could be cleared up by a few enquiries and the results confirmed within a week. The necessary changes should begin within a month and be completed within three months. This may sound like a very accelerated timetable, as compared with normal, incremental changes. However, the comments made in the previous section about speed in turn-round are paramount. It may be plausible to break the strategic value process into distinct sections, rather as Ricardo Semler did with Semco [3]. For example, it is possible that the internal structure and process issues could be completed before the team issues were addressed and that the team issues could be completed before the environmental issues were addressed. However, the momentum must be maintained if a premature return to incrementalism is to be avoided.

Before embarking on the strategic value process, it is essential to ensure buy-in by the senior executive, by the owners and by any trade unions that have an agreement with the organisation. It should be borne in mind that the results are expected to be a transformation to an organisation that is more profitable, more flexible and more attractive to customers. From the employees' point of view, the organisation should be more enjoyable, less stressful and financially more rewarding to work for. There may well be a need for some redundancies. However, for the majority who remain, the benefits will contribute to a significant increase in value.

5 Conclusions

We have seen that a value management approach can be applied to organisational strategy. The value management concept of challenging current wisdom, looking at fresh ideas, assessing their feasibility and evaluating the costs and benefits of various options provides a rational approach to reinvigorating an organisation with a performance that lacks lustre. There are examples that indicate the great benefits of using the value approach, although in many cases, those involved did not realise that they were, indeed, using such an approach. The practical implementation of strategic value management relies on appraising every aspect of business functions, processes and objectives using the value management approach. Use of strategic value management should lead to a rapid reinvigoration of an organisation.

6 References

[1] G Johnson, *Rethinking Incrementalism*, Strategic Management Journal **9** (1988)
[2] Townsend R, *Further Up the organisation,* Coronet Books (1984)
[3] Semler R, *Maverick*, Arrow Books (1994)