Session 4 (JW)
Influencing Strategies:

The Rational Organisation

Week 4 (Friday)

MAST4001 & MASTG003

Student handouts to be distributed in class

Session 4
Influencing Strategies:
The Rational Organisation

Today

- **To introduce:**
  - **A framework for analysing the decision-making environment**
  - **The first of these 4 decision environments - the Rational Organisation (Computation)**
- **To consider the merits and limitations of the rational / numerical approach to decision-making**
- **To discuss the influence of key stakeholders & the need for consultation**

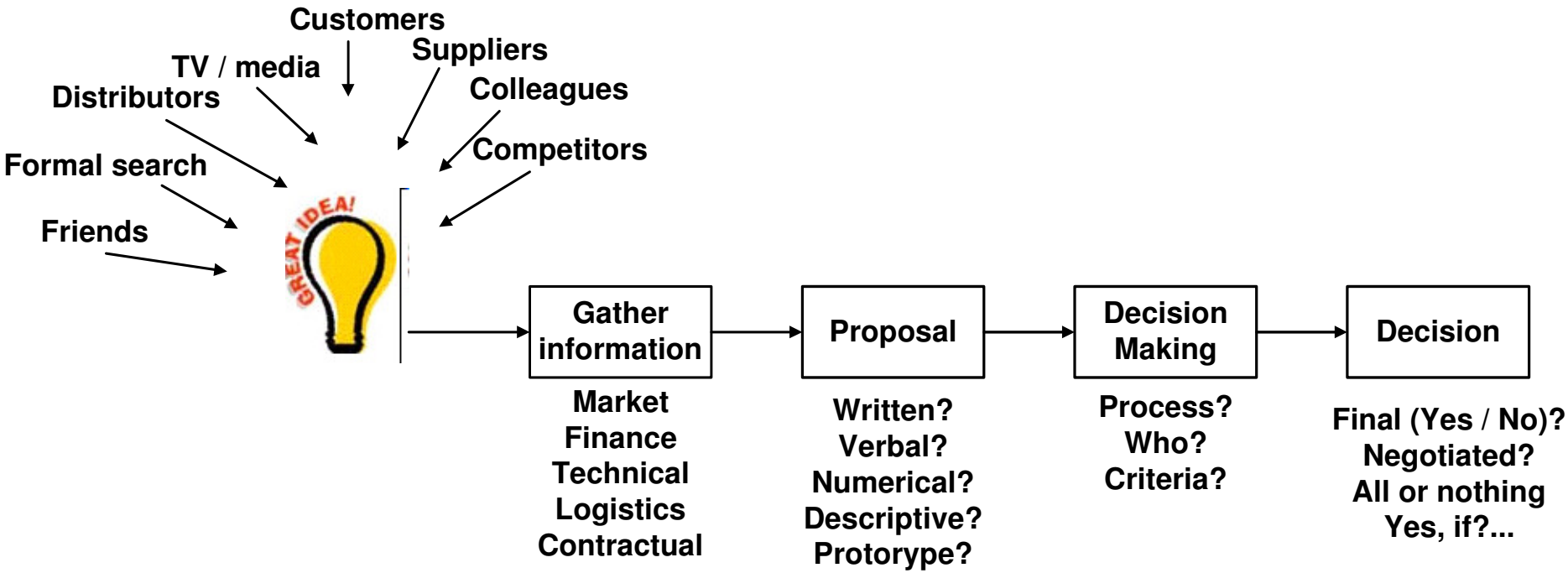
Objectives

- **At the end of this session you will be able to:**
  - **Describe the benefits, risks and getout criteria that may be applied by decision-makers**
  - **Explain the merits and limitations of the rational approach to decision-making, and the implications for the new product / innovation proposal**
  - **Explain the importance of consultation with key stakeholders**

Decision-Making in Organisations

- **Individuals contribute to innovation by:**
  - **Generating new ideas**
  - **Gaining approval for the idea**
  - **Implementing the idea within the organisation**

Stages in Decision-Making



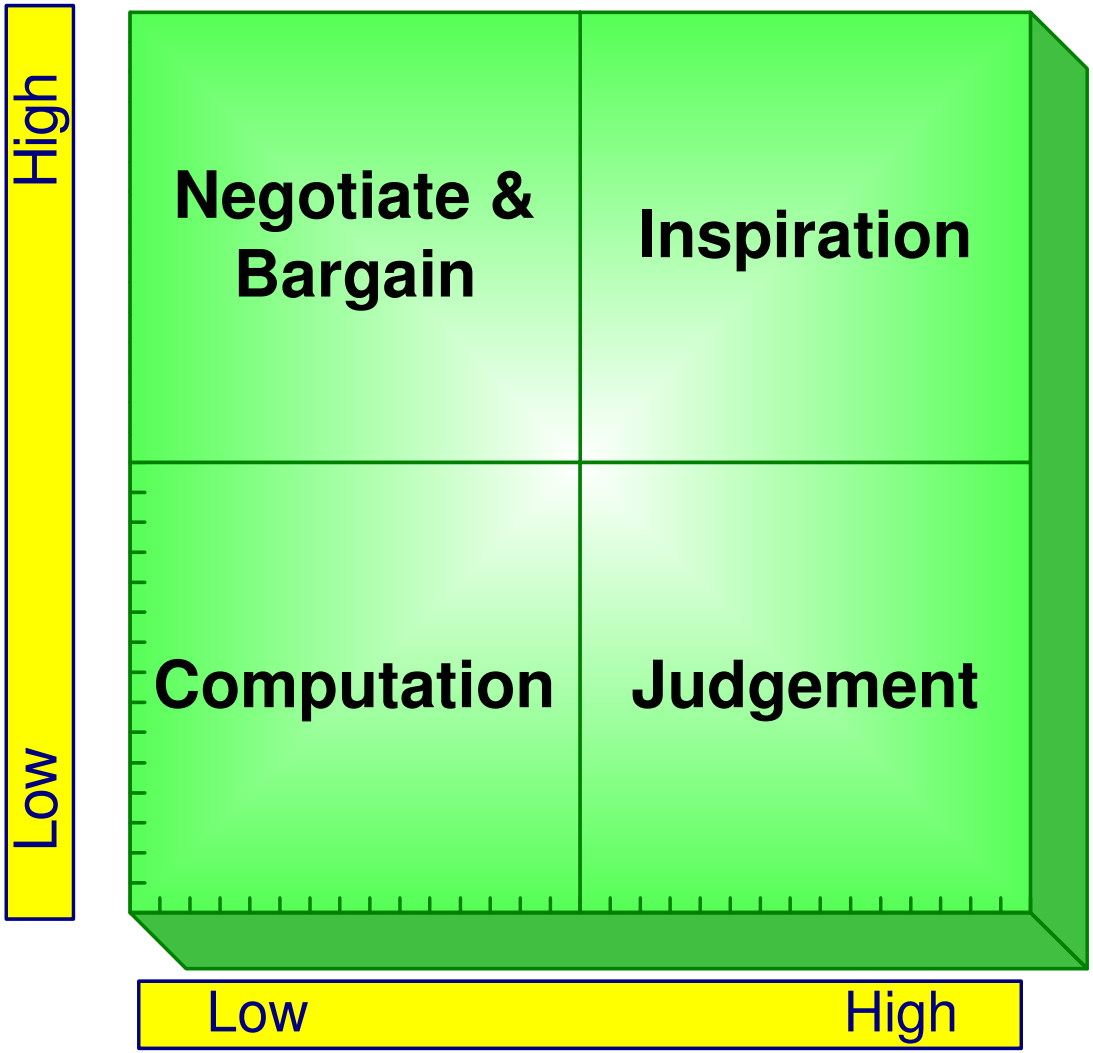
Understanding Decision-Making

- **The Process:**
  - **How the decision is made (formal / informal channels)**
  - **Who is involved in the decision**
- **The Criteria: How proposals are judged, e.g:**
    - **Fit with strategy and DCs**
    - **Feasibility given the T,C,P strands**
    - **Other criteria / agendas**
- **Whose support is needed to implement the project (and their needs / interests)**

Influencing Strategies

- **JW's next four sessions:**
  - **Understanding (4) different decision-making scenarios**
  - **Influencing strategies to get the idea approved and implemented**

Uncertainties over methods / consequences / outcomes

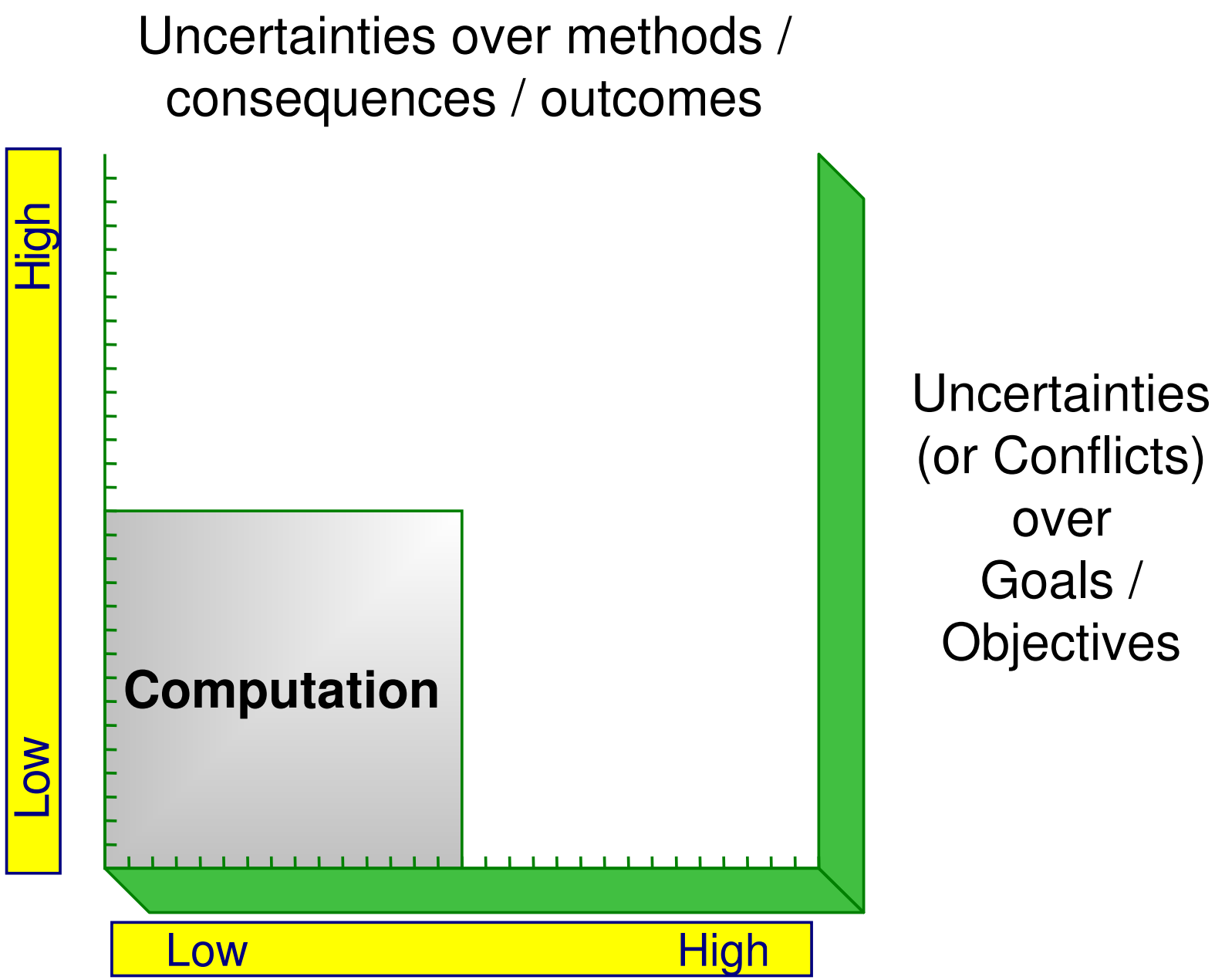


Uncertainties (or Conflicts) over Goals / Objectives

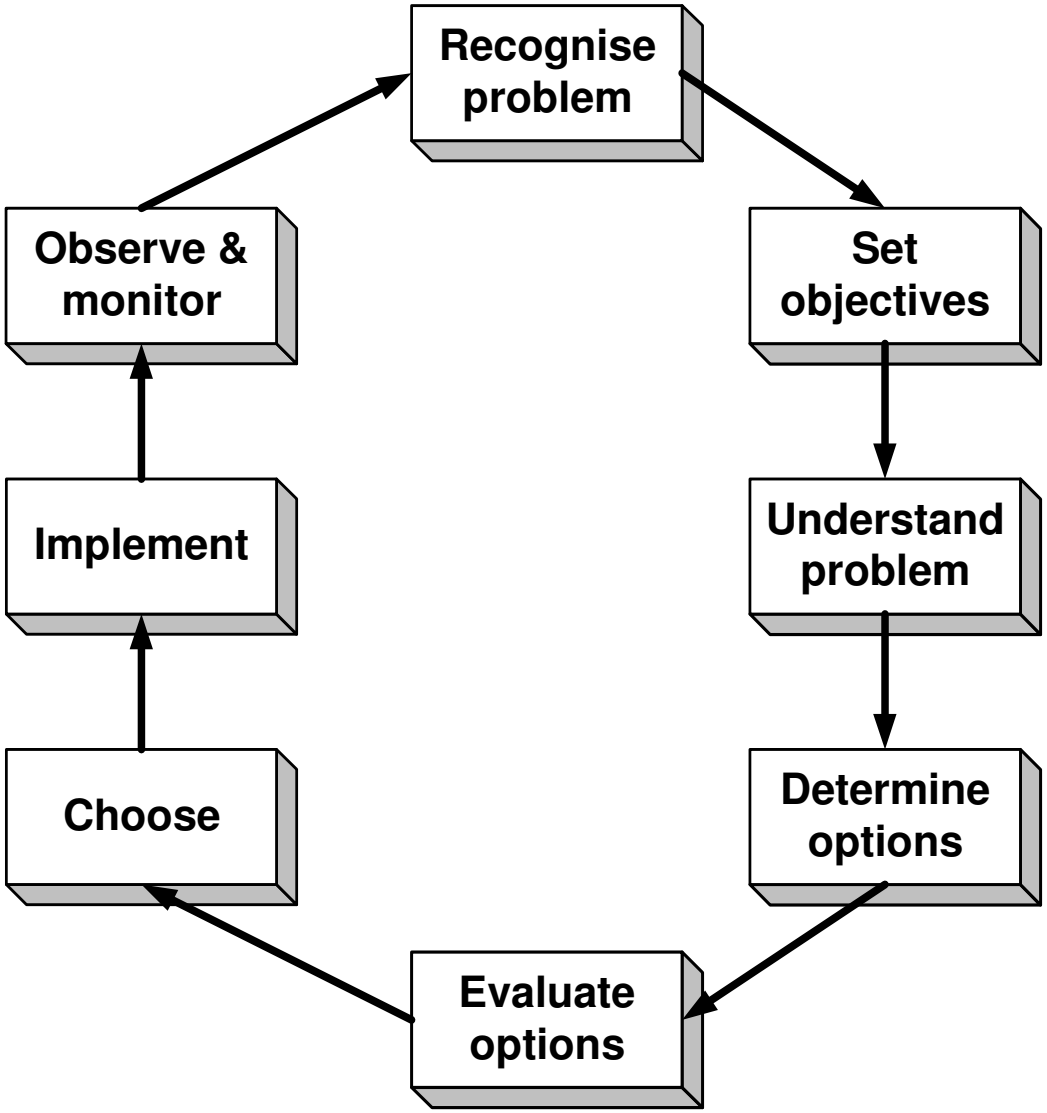
Adapted from Rosenhead

Assumptions For Today

- **Reasonable certainty over methods / consequences / outcomes**
  - **Managers are able to understand methods / visualise outcome and advantage conferred**
  - **Decision is fairly routine and outcome easy to evaluate**
- **Reasonable certainty over goals / objectives (no conflicting interests)**
  - **Managers will judge on the basis of what is good for the organisation**
  - **Will not let self-interest get in the way**


Uncertainties over methods / consequences / outcomes
High
Low
Computation
Low
High
Uncertainties (or Conflicts) over Goals / Objectives

Normative Decision Model

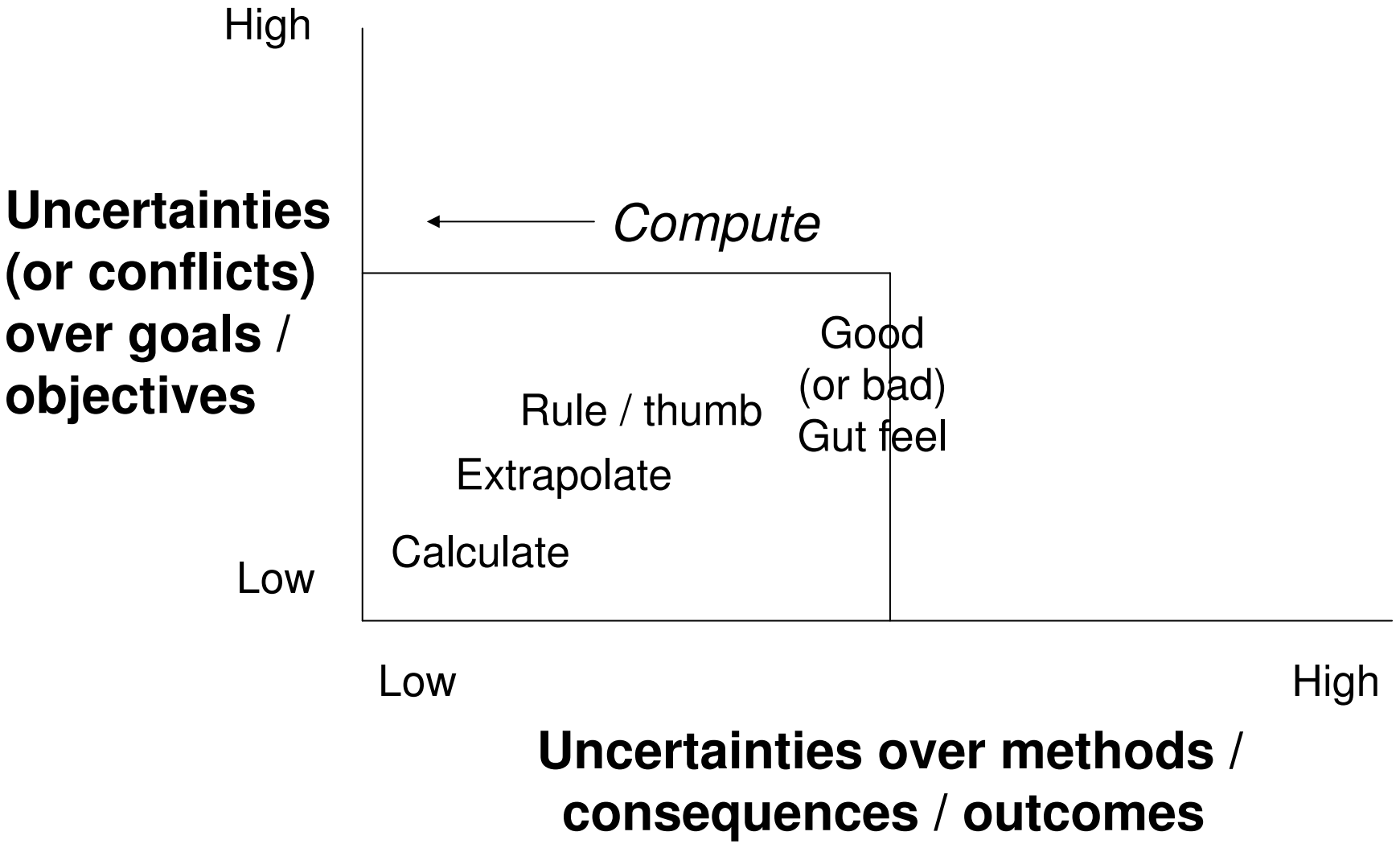


Source: Cooke & Slack, cited in Teale et al

Typical ‘Computation’ Decisions

- **Decision judged rationally, e.g:**
  - **Product modification**
  - **Extension of an existing product line**
  - **Planning permission for a loft conversion (which doesn’t adversely affect neighbours)**
  - **An advertising campaign**
  - **Soft drink sales as a function of the weather**
- **Where methods, outcomes well known**
- **No-one in power loses out (no conflicting interests)**

Degrees of ‘Computation’



A New Soft Drink

- **You have recently graduated and joined a major soft drinks company as an assistant product manager.**
- **You have an idea for a new line of drinks, a range of organic ‘smoothie’ fruit-flavoured drinks aimed at children and young teenagers.**
- **This is an identified gap in the market, and you believe this new product line will be a market leader.**
- **Your boss suggests that you prepare a proposal to submit to senior management**

Your Task

- **Prepare an outline proposal, by means of a list of issues that your proposal should cover**
- **What other factors are management likely to consider when evaluating your proposal?**
- **Is there anything, in addition to the written submission, that you might do to increase the chances of gaining approval for your idea?**
- **Presume:**
  - **Everyone will understand the concept and what it involves**
  - **Everyone will act in the best interests of the organisation**

Example Proposal Structure

- Executive summary
- Introduction / background
- Market background
- Benefits
- Resources required
- Timescale
- Key risks and dependencies
- Legal issues
- Financial appraisal

Benefits

- **For example:**
  - **Profit**
  - **Market share**
  - **Increased distribution, more shelf space (increase company / brand profile)**
  - **New market segment (1st mover advantage)**
  - **Company growth**
  - **Fit with strategy and DCs**

Costs

- **Financial and other resources**
  - People (R&D, Production, Marketing etc.)
  - Equipment (e.g. test, production plant)
  - Raw materials
  - Time
  - Opportunity cost
- **Contractual**
  - Packaging suppliers (containers & design)
  - Market research (agencies)
  - Advertising & promotion agencies

Risks

- **Financial**
- **Market, e.g:**
  - **Distributors won't stock**
  - **Distributors stock, market doesn't buy**
- **PR / Reputation**
  - **If product fails in the market**
- **Technical**
  - **Product tastes awful (unable to develop flavour formula)**
- **The Proposer**
  - **A new person, competence? No track record**
- **Costs of early termination**

Early Exit Costs

- **Includes:**
  - **Contractual liabilities**
  - **Customer / supplier relationships**
  - **Reputation**
  - **Financial write-offs**
  - **Personnel (e.g. redundancies)**
  - **Plant and equipment installed**

Getouts

- **Minimise early exit costs**
  - **Phased Investment**
  - **Opportunity to stop at each stage of NPD process**
  - **Thorough testing**
    - **Technical**
    - **Market**
    - **Small-scale market test before national launch**

People Risk

- People can escalate the risk factor on a project
- Teams, not individuals, are units of performance
- Team and leader will be judged on:
  - Competence, commitment to project, trustworthiness (loyalty to organisation)
- Proposer's track record / credibility / support from influential people reduces perceived risk

Other Actions

- **Consult / discuss with other departments**
  - **e.g. Marketing, R&D, Production etc.**
  - **Use their input to improve / perfect proposal**
  - **Will also need them to develop & launch the product, so need their agreement**
- **Support of Influential people**
  - **e.g. Your boss (and his / her network of contacts)**
  - **New person will have insufficient credibility on their own**
  - **Find out what decision-makers value to tailor the proposal accordingly**

Consult & Negotiate

- **Many think that proposals are written in isolation and then submitted formally**
- **Sometimes this is the only way**
  - **e.g. Closed bids**
- **However, most successful proposals usually involve consultation / negotiation**
  - **Should be lots of discussion before finalising proposal**

Benefits of Consultation

- **Need support of others in the organisation to implement**
- **The *less* decision-makers trust / know about the people involved, the more evidence they need to substantiate assumptions and assertions**
- **If key managers have helped to shape proposal, find it harder to subsequently reject**
- **Better proposal as wider perspectives and ideas included**
  - **But may have to compromise, fine-tune proposal**
- **Creates trust & political & social capital (more about these later in the course)**
- **Aim to get the decision for your proposal to be just a rubber-stamping exercise**

The Proposal

- **What any decision-maker wants to know**
  - **The merits of the idea itself**
    - **Net Benefits**
    - **Risks**
    - **Getouts**
  - **The people involved (Will they deliver?)**
    - **Competence**
    - **Commitment**
    - **Trustworthiness**
  - **Do key stakeholders support the project?**

Net Present Value (NPV)

- **Evaluates the financial return of investment(s):**
  - **Compared to the firm's interest rate (cost of borrowing / cost of capital)**
  - **Taking account of the time value of money**
- **Often used as a basis for choosing between different proposals (more opportunities than funds)**

The Time Value of Money

- If you invest £100 in a building society at an interest rate of 10%, in one year you will have £110
- Therefore the Present Value of £110 in one year is £100
- Anything that offers a lower return isn't worth doing (unless for altruistic reasons)
- Could invest in, e.g. the stock market, in the hope of a higher return – but this is higher risk

Time Value of Money

- **The organisation will expect an investment to generate a return which is higher than the interest rate over time because:**
  - **Otherwise it might just as well invest the money in a bank (if it has the cash)**
  - **It has to pay the interest rate to borrow the money to fund the project (if it doesn't have the cash)**
- **NPV brings forward future cash flows to today's value using a technique called Discounted Cash Flow (DCF)**

How To Calculate NPV

1. Write down all cash flows (in / out) associated with the project over its life
2. 'Discount' net cash by the firm's interest rate (cost of borrowing / cost of capital) to bring to today's value
3. Add up all 'discounted cash flows' associated with the project.
4. Subtract any initial investment
5. This gives the 'Net Present Value' (NPV) of project
6. If NPV is positive, then project earns more than cost of capital; if negative – it loses money; if 0 – it earns the same as the cost of capital

NPV Layout

Yr	Net Cash		Discount factor		DCF
0	£ in /out	x	$1/(1+r)^0$	=	DCF YR 0
1	" "	x	$1/(1+r)^1$	=	DCF YR 1
2					
3 etc					
TOTAL					NPV

The Discount Factor (DF)

r = interest rate, then

DF =

$1/(1+r)^1$ for net cash in year one (as at end of year)
$1/(1+r)^2$ for net cash end of year 2
$1/(1+r)^3$ for net cash end of year 3
$1/(1+r)^n$ for net cash end of year n

NPV Example

- A machine costs £7,000 and will enable the firm to earn the following net cash flows:
- year 1 £4000
- year 2 £5000
- year 3 £5000
- year 4 £3000
- The interest rate is 10%. Should the firm invest in this machine? Assume machine has no scrap value

NPV - An Example

Yr	Cash		DF		DCF
0	(7000)	x	1	=	(7000)
1	4000	x	0.909	=	3636.36
2	5000	x	0.826	=	4132.23
3	5000	x	0.751	=	3756.57
4	3000	x	0.683	=	2049.04
NPV					6574.21

NPV > 0, so go ahead

NPV – Practice Question

Year	Net cash	DF	DCF
0	(600)	1	(600)
1	50	0.893	44.64
2	250	0.797	199.30
3	250	0.712	177.95
4	200	0.636	127.10
NPV			(51.01)

Benefits of Financial Analysis

- **Essential – investments involve financial commitments**
- **Forces you to think through and state assumptions**
- **Numbers are (relatively) easy to make a judgement about**
  - **Can do ‘what-ifs’, test scenarios etc.**
  - **Provides an ‘objective’ base of comparison between projects**
- **Shows your commitment and empathy with DM thinking**

The Problem With Numbers

- Based on estimates of the future (uncertain)
- Open to manipulation
- Different methods will result in different ‘best projects’
- Project ‘stand-alone’ appraisal doesn’t capture all benefits (or downsides), e.g:
  - Longer term benefits / application on future projects
  - Implications of project elsewhere in the business
- What happens if you don’t go ahead
  - False assumption that status quo will continue

The Sony Walkman (1979)

- **“Sony co-founders Akio Morita and Masaru Ibuka came up with the idea, but their own product development team almost rejected it, predicting sales of just 5,000 units per month. Two months after its launch 50,000 units had been sold….sales reached 100 million in spring 2000”**

Source: Marketing magazine, 13 July 2000

The Rational Decision Process

- Objectives of organisation are set (financial / strategic etc.)
- Proposal(s) brought to the attention of management
- Management evaluate the opportunity:
  - Benefits, risks, getout points & the people involved
- Select option which has highest net benefit

The Decision Process

- **Even in the 'Computation' (rational) environment**
  - **Decision rarely a mechanical calculation process alone**
- **Computers don't make decisions - people do:**
  - **Usually by consultation / in committees**
  - **Routine / familiar decisions can be made on the basis of numerical analysis, rule or precedent**
  - **Not every aspect of the decision can (or should) be reduced to numbers**
  - **Still involves managerial judgement**
- **Consultation & discussion**
  - **Most decisions are not solely a 'paper' exercise**

Investment Decisions

- **Even in 'Computation' environment, approval not a foregone conclusion**
- **All investment decisions involve:**
  - **Committing / risking scarce resources (cash, people, management time etc.)**
  - **In order to reap future benefits**
- **However not all investments reap expected benefits**
- **Decision-makers know this, and are therefore sceptical of <u>all</u> proposals**
- **Also have limited budgets (more opportunities than resources)**