

beyond... the mbh newsletter



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Editors Comment

One of the buzz phrases of the past 5 years has been Customer Relationship Management (CRM). CRM projects have ranged from small tightly focused expansions of a businesses data warehouse to more ambitious holistic approaches that attempt to solve legacy issues, knowledge management and problems with customer relationships all in one go. Unfortunately, possibly even more than any other IT championed project, the value created has been minimal at best and value destroying at worst. This newsletter highlights some key points that are consistently missing in the bad ones and consistently present in the good ones.

The second issue in this series of newsletters (November 2001) talked about the value of option pricing of real assets. It is pleasing to see the increasing talk and documentation that is coming out about this type of project evaluation technique. We return to this topic in our second article as our Managing Director expands on what is his pet topic (just don't get him talking about it on a Friday evening).

Article one - The rise and fall of Customer Relationship Management

Over indulgences are common in business. Many a fad has come and gone where a project champion, "group think tank" or other concept "paradigm shift" guru has espoused some great idea only for that idea to be raped and pillaged by the greasy poll climbers in hierarchical organisations. There is no better example of this than Customer Relationship Management programmes. The hype and fan fare over this concept led to many organisations seeing the technical solution as the cure all for the ills of the business. As business after business went through the initiative with disastrous results, the acronym CRM changed from Customer Relationship Management to Could Ruin Me. The end result is that many companies will not touch CRM no matter what sort of business case is put forward. The good part of this is that significant opportunities now exist for companies with the project management skill, executive buy in and intestinal fortitude to take on the monster that is CRM. A well implemented change programme to CRM provides businesses with a key differentiator from there competitors and can lead to some significant process improvements (read headcount savings) too.

What is CRM?

Gartner defines CRM as a "business strategy, the outcomes of which optimise profitability (we would hope all initiatives would do this), revenue and customer satisfaction by organising around customer segments, fostering customer satisfying behaviours and implementing customer-centric processes". (MIS Magazine Dec 01-Jan02 page 27, for more information regarding life cycles of CRM see the Dec01-Jan02 issue of MIS magazine. www.misweb.com). By this definition, CRM sounds like a cause worth championing. What is missing from the definition and what is minor in achieving the overall benefits is vendor selection. Far too much emphasis is focused on IT functionality and in getting the best vendor and not enough on the change elements that are created by the new processes.

Facts and survey's

First to some statements and facts. Thanks to our friends at Gartner, we have some beauties. In 1999, Gartner reported that Vendor led solutions were the single largest road block to successfully implementing a value adding CRM strategy. Gartner still considers CRM to be an imperative in most businesses corporate strategy , however, it is quoted as saying "More than 75 per cent of enterprises engaged in CRM initiatives are incapable of combining a comprehensive view of the customer with actionable, personalised advice to customer or sales/service agents."(MIS Magazine Dec 01-Jan02 page 11). Added to this, once again, feasibility assessments and benefits management are significant items lacking from the methods used in running CRM projects. Once again, Gartner are quoted as saying that expenditure on CRM initiatives will blow out by between 40 - 75% on CRM projects between now and 2006 (PM network Dec 2001 page 10).

Key lessons to learn

Listed in this same article are the following key project management tools to successfully implement CRM (we would go as far to say that these tools should be prevalent in ALL projects):

- Benefits projection
- Return on Investment projections (see article two below)
- Work plans for implementing technology
- Total cost of ownership, a holistic view of information technology costs over time, which considers people, processes and technology.

The key points for MBH to highlight is the first two. Benefits management and valuing a project in terms of NPV and option pricing are crucial in ensuring that the expenditure that is going to be allocated to CRM is valid. Expect more from us on this issue in coming newsletters.

Article two - Understand the value in strategic value

As readers of our monthly newsletters will realise, MBH has been a major champion of using option pricing to value the yes/no decision of project selection. When you consider that most companies have to choose from a variety of ideas during a year and that only a fraction of these ideas can be implemented within the resource constraints of that company, it is interesting the it has taken 35 years for this concept to finally start to catch on. It was with great pleasure to read in the Project Management Journal the article by Michael Farrel on the value of the abandonment option. It has consistently been our experience that the abandonment option has outweighed the continue option in over 80% of projects being undertaken within clients we have consulted to. The value this creates in actually abandoning the projects is probably greater than the rest of the change programme put together (although, for the situation not to occur again, an Managing by Project methodology has to be adopted, with associating changes in the corporate culture).

What is all this Option Pricing stuff anyway?

Have you ever had board member, an executive or senior manager say that a project must go ahead no matter what its NPV is because it is strategic? What do they mean when this is said? The only explanation that is possible is that the value of the follow on investment options outweighs the cost of the initial investment. In finance speak, what this represents is the purchasing of a call option. By getting into a market early or by improving the operational capability now ready for an upturn in demand etc, a company can take full advantage of the future options that fall its way. How does a senior manager know that the option value outweighs the initial negative NPV project? The answer is that they don't. However, they could know if they applied a little financial engineering (the funky new term for financial analysis) to the concept. The financial engineering that is required is to calculate the present day value each option of follow on investments.

Pricing real assets is too difficult!

This is the most amazing thing about option pricing, it is not difficult. The development of the various option pricing formulas (Black Scholes, binomial, decision trees etc) means that models can be built easily IN EXCEL! All that you need to calculate an option's value is the following:

- 1) The options current cost - This is the negative NPV of the first project
- 2) The exercise price - The cost of investing in the second project
- 3) The underlying assets present value - The present value of the second projects cash flows
- 4) The time until an investment decision has to be made
- 5) The standard deviation of the investment - This is a measure of the uncertainty of the forecasts and can be calculated using statistics based on market research or estimated from previous data (eg most IT projects have standard deviations greater than 40%)

It is this last figure, plus the length of time taken before an investment decision needs to be made that creates the value in the option. Once these values are known, the options value becomes a simple matter of plugging the numbers into the model. This can be done several times to test sensitivity's to the underlying assumptions. If the value of the option is greater than its cost (i.e. the negative NPV of the first project) then our senior manager was correct in saying that the first project should go ahead because it is strategic. In essence, what we have done is value the strategic value rather than just say it is strategic.