

'Rock Paper Scissors' and other Business Decision Tools

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Everyone remembers Rock Paper Scissors, right? On the count of three, each kid makes one of three symbols, and they're compared: rock breaks scissors, scissors cut paper, paper wraps rock. It was the ultimate arbiter, the tie-breaker, it was how vital decisions were made on lazy summer afternoons: Should we climb the tree by the river? Buy candy or buy soda?

Dilemmas like those we faced as children are a bit different from the ones we face in the business world: Do we move our office downtown? Do we buy computer equipment or lease new trucks? Should we hire that new marketing guy? The most significant difference is that nearly every decision we face in the world of business has an end besides the action itself - we are trying to increase the bottom line. And that has major ramifications for how we approach business decisions.

We invest in a new company because a friend owns it; we buy a company car because we have always wanted a convertible; we hire the person who "looked more honest" than the other applicant. These decisions are made by gut feel or relationship, and don't have much to do with the goal of your business: increase the bottom line. It's time to sit back and realize that decisions should be made with an eye to profit, not how you'll feel in that new convertible.

Before we go any further, let's redefine the word "project" for the purposes of our discussion. Here we go:

Project (PRA-jekt). *Noun.* **A course of action that results in a change in the bottom line.**

Examples: pick a \$20 bill off the sidewalk; expand your office space; install a new customer tracking program on your computer.

There are two benefits to thinking about projects this way:

1. Defining project impact as a change in bottom line dollars, **we can compare projects to one another**; and
2. It forces us to **evaluate projects by the outcome** on our business.

So how do we estimate a project's bottom line impact? First, list out all of the extra costs you incur to perform the project, then the extra revenues you should be able to get as a result of the project. It's useful to set a timeframe equal to life of the new project's benefits for the estimate (e.g. if you want to sell the business in two years, use that for the

timeline for all costs and benefits).

Let's think about the \$20 bill example: you're walking down the street and see the bill. If you pick it up, you gain \$20. If you leave the bill, you don't suffer a loss of any kind. The value of the project is easy to estimate: it's \$20. You compare the two outcomes, then pick up the money and are better off by \$20.

Let's take a look at a more realistic case:

Example: A computer repair facility has enough space to allow two technicians to work at the same time. By expanding their shop space, they can hire a third employee. Should they expand the shop?

Project Cash Flows for next 12 months:

Estimated Costs:

Costs of hiring, training, remodeling, additional rents

\$1,000 Planning time: shop owner and other employees

\$2,700 Cost of construction / remodeling

\$250 Time spent rearranging after the remodel

\$875 Time spent interviewing / hiring third employee

\$28,800 New Employee's wages (and relevant taxes)

\$1,350 Time to train New Employee

\$2,400 Additional rent for new space for 12 months

\$37,375 Total Cost Estimate

Estimated Revenues:

Additional work that a new employee could handle in the next 12 months

\$48,000 Billable Revenues

\$(37,375) less Costs from above

\$10,625 Net Value of Project

This shop owner is wealthier by roughly \$10,625 by expanding the office space and hiring the third employee. Even if the numbers didn't work out during 12 months, it might make sense if you looked at 24 months. For example, the second year would likely be even more profitable: as all of the remodel costs don't recur, and the employee probably becomes more and more efficient at generating billable hours.

In the real world, we usually don't have enough money to do all of the things we want to: we're constrained by how much money we have in the bank. Now we need to compare projects to decide which one to take on.

Let's assume that we are forced to choose between the office space upgrade and installing a new program to track customer billing. Each project would take about the same amount of time and resources. You calculate that the program should save \$6,000 this year by reducing time to collect on invoices and preventing some uncollectible accounts.

Since we've estimated the dollar value of each project, we can simply compare the dollar values and execute the project with the higher value to our bottom line. In this case, we put the program on hold and build out the office space. We can probably use some of the extra profits generated by the third employee to fund the billing program later.

What we're left with then, is a way of managing our bottom line by thinking about every decision in terms of dollars. We can compare projects and evaluate them based on how they contribute to bottom-line profit. You should feel comfortable that when you undertake a new project, you understand how you are adding to your bottom line.

When viewed under this lens, buying the convertible suddenly doesn't look as good as it once did. Of course, you can still choose to buy it anyway, just understand how much you're paying for that sunshine and wind in your hair.

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