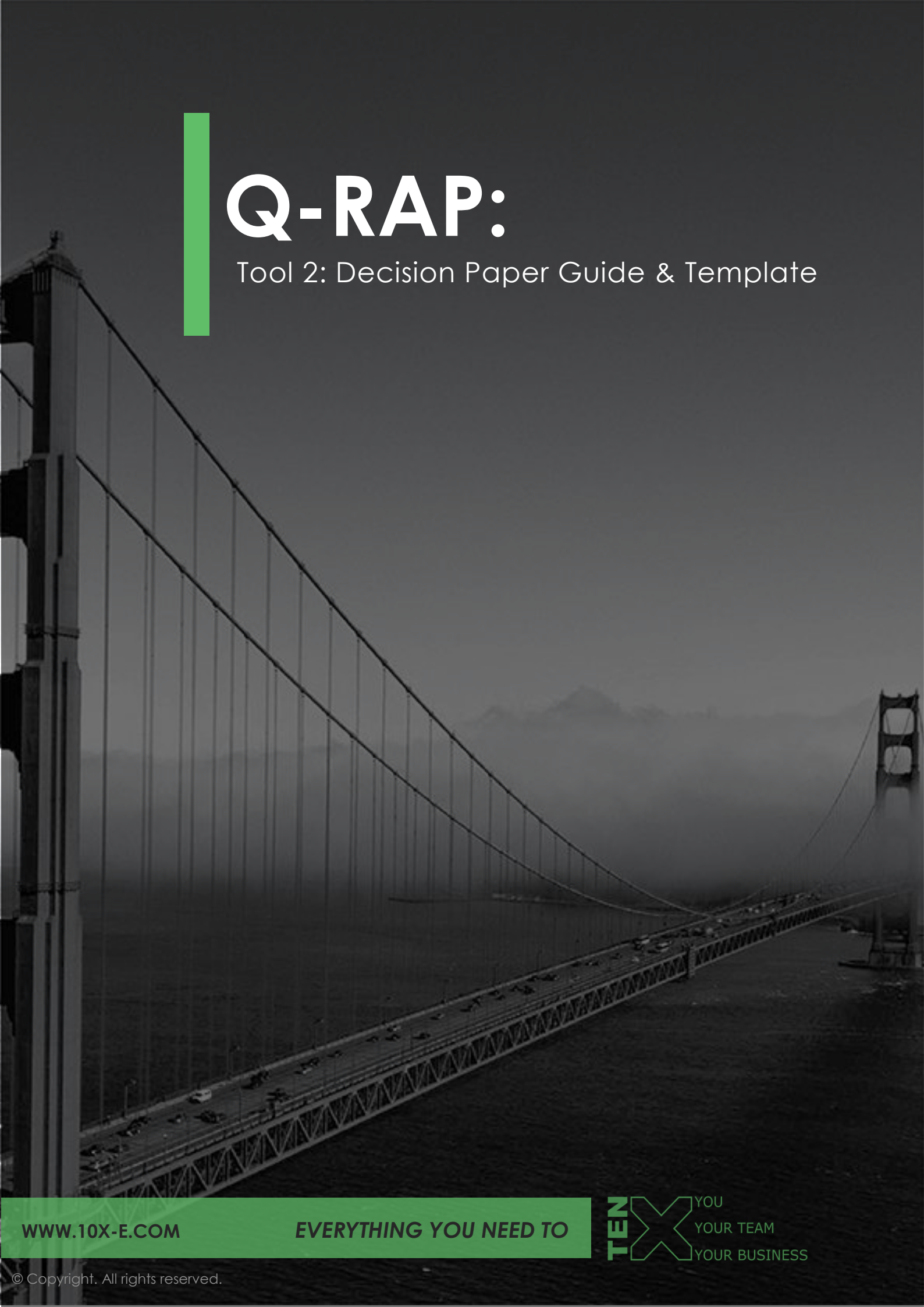

Q-RAP:

Tool 2: Decision Paper Guide & Template

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1. INTRODUCTION

As Companies Scale Up, decisions become more complex and Founders become increasingly incompetent to make the big decisions without a good process (for reasons explained below). One of the critical shifts good Founders make is from entrepreneurial decision-making to an efficient - but effective - decision-making process. This short guide unpacks who and how to make that shift.

2. DECISION MAKING DYNAMICS IN START-UPS AND SME'S

Startups are experimental enterprises - they are still seeking, refining, and proving their concept and business model through informed trial and error. Things move very fast. Things change drastically, every day, week, month or quarter (depending on how mature the SME is). Furthermore, the enterprise generally begins with 1 or 2 key people who can have effective oversight over everything. Finally, in most entrepreneurial ventures, the shareholder is the Director and the MD; there is hence no conflict of interests for the MD in making decisions. It is their money and their risk.

Therefore, most decisions in a startup are typically made by executive decision, and fast. There is no need (or time) for process or procedure in a nascent business where, ultimately, the business is still experimental and the organisation is thin, fast-moving and agile.

To corporate types, this may seem like a major problem at first, but it is actually the opposite. A primary reason most good SME's survive (and ultimately prosper) is because of greater speed, more customer responsiveness and lower costs, relative to more established businesses. At a small scale, an SME can out compete most corporations in service, turnaround times and cost, with lower overheads, because of nimbleness in the management structure and because of the "start-up management" approach. It is critical in an early stage company to retain this advantage of nimble management.

Therefore, it is appropriate in a start-up that most decisions (though not all) remain decisions made fast, by the entrepreneur, applying their own business judgment. It will work out badly sometimes but, on balance, the benefits of the speed and nimbleness that come from "start-up management" outweigh the decisions made badly.

3. THE CHALLENGE OF SCALING UP

But things change when you Scale Up.

As Investors and SME Advisors, we have worked with some of Africa's Premiere growth firms over the last decade. Our experience is sobering. Of the top 1 percent of high potential ventures - by growth potential and strength of team – 70 percent get stuck in the Bermuda Triangle of growth[1] within 3 - 5 years of "taking off":

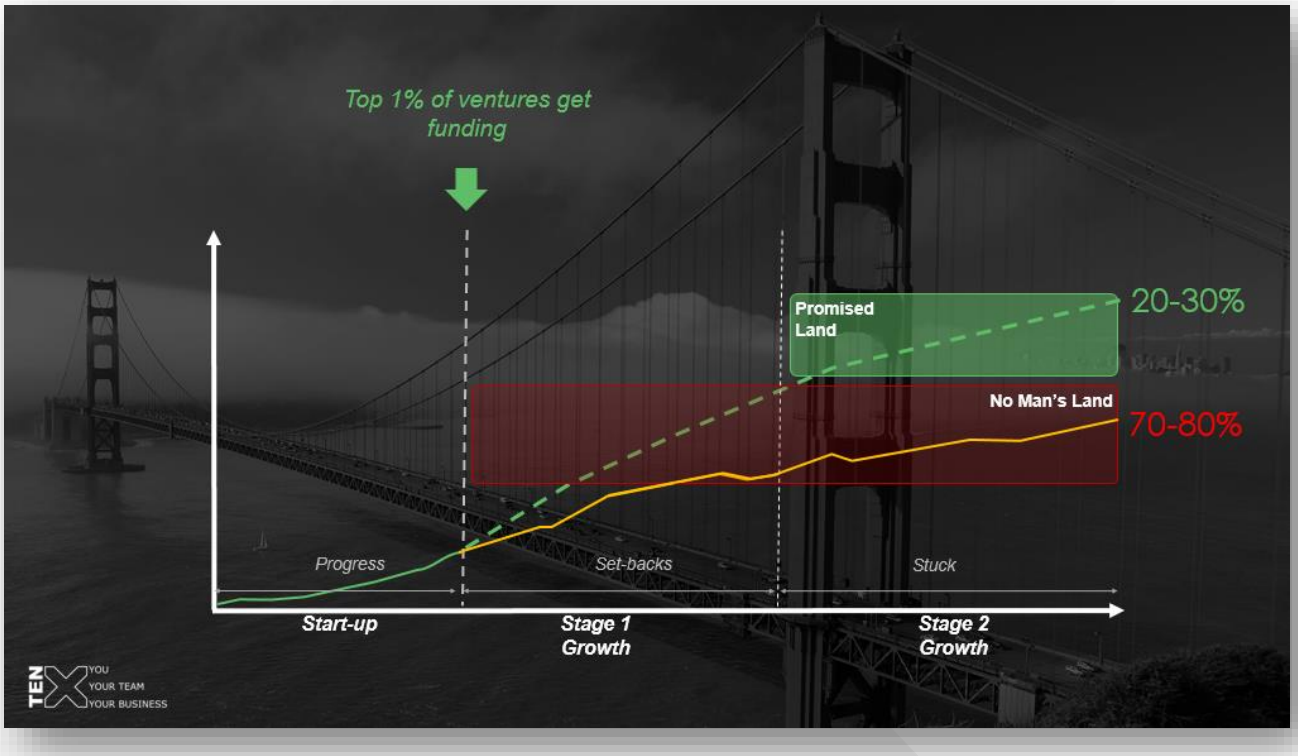

Figure 1: Analysis of the Top 1 percent of high potential ventures

This is a normal phenomenon, globally. That's why there's a well-known book by the title 'No Man's Land', which describes this as the typical outcome for growing companies (Summary here). The problem is, when this happens, neither the Funders nor the entrepreneurs make money.

[1] *'No Man's Land' is the most volatile time a small business experiences during rapid growth, when the business is "too big to be small, but too small to be big." During this phase, normally between 10 and 100 employees and R10m and R100m revenue (depending on sector and business model), the business typically needs to change its management team, market offering, target market segments, business model and pricing, and capital structure. Many of these changes are emotionally and psychologically unbearable for Founders, which is why most companies get lost in No Man's Land and never make it out. Those that do make the very hard changes that are required.*

> ***The reason that this problematic phenomenon exists is because everything changes when you scale a business.***

As the business gets bigger, the organisation structure changes, the management needs to formalise and professionalise and the management skills required change. This has several very important knock-on effects:

a) The culture must shift from 80 percent familial and heroic: 20 percent systematically generating predictable results, to the other way around;
b) That means the leadership style must shift from Directive and Entrepreneurial to Participatory and Professional (without losing the 'Founders' Mentality');
c) Often, the average salary normalises upwards from below market (based on early loyalty to the mission and founders), to matching the market. Several other elements of the 'startup cost advantage' must be normalised;
d) The higher cost base changes the cost structure and hence the basis for profitability;
e) That means that either the price-point must change or they must navigate through a massive profit 'hockey stick' until they achieve a massive increase in volume that renders them profitable once again;
f) If the price-point must change, that typically requires focusing on a more lucrative customer segment;
g) This often requires enhancements to the product offering or feature set;
h) In summary, this entails a revised strategy; and
i) Sometimes that new strategy geared for scale requires a new operating model.

In summary, everything changes.

4. SCALING UP AND DECISION-MAKING

One of the most important changes that take place when a business Scales, is how to make good decisions.

When you're a start-up, the best way to make decisions is through the Founders making quick, judgment-based calls. That's appropriate when Founders know almost everything about the business and know more than almost everybody else in the business about the industry, market, customers, etc.; it is also critical when speed is of the essence.

That changes when any of these things change:

a) **The business becomes too big for Founders to be 'on top of everything':**

Typically, this happens when the business reaches a headcount of15-30 employees, and real 'managers' emerge - taking responsibility for entire parts of the business (like Sales, or Ops, or HR). Suddenly, if Founders make decisions without consulting other senior people, they're likely to be missing crucial data points and perspectives that would materially impact the right decision.

b) **A Management team starts emerging:**

This can happen before the business reaches the scale indicated above, if the business hires senior people early on.

c) **You raise venture capital, private equity, or bank finance:**

If you raise outside institutional funding, investors begin to expect more professional management, which includes an effective process for making the big decisions well.

When any of these 3 things change, the primary nature of the decision-making process must change. If Founders continue to make decisions in the same way, then they will:

- Make decisions with significant blind-spots;
- Make costly, avoidable mistakes;
- Disempower their teams;
- Lose talented people;
- Lose credibility with investors and/or the Board;
- Struggle to raise further capital; and
- Probably be fired by the Board, if they're any good.

d) **You decide you want to build a business that serves you, rather than you serving it!**

In other words, the business works with and without you, so you can take holidays, sell, work reasonable hours and spend time with family or doing other things you enjoy – all of which require a professionally managed business that works, even when you're not there to keep things together.

Scale Up leaders need to shift:

From:

Founders making quick, good judgment calls, on the fly;

To:

Founders ensuring the big decisions follow a process that gets the right brains to work together to identify the best way forward.

This means managing an effective decision process so that the key people (who each bring crucial perspective and input to the decision) can:

- get the information they need;
- understand the options;
- give their perspective and input;
- engage in a robust debate;
- ideally achieve collective understanding about the situation, options, pros and cons of each option, and
- ultimately achieve consensus on the best way forward.

Scale-up CEO's should therefore:

- Insist that the 10 percent of decisions that are "big-stakes" are made prudently (based on careful evaluation and through a suitable governance process); and
- Leave 90 percent of the decision-making to the "start-up management" approach - that is, the business is led and governed through the MD being involved in everything and making decisions fast and by executive decision based on his or her business judgment.

> ***The objective of this guide is to help Founders to prepare for the 10 percent of 'Big stakes' decisions***

5. PROCESS

The table below illustrates a generic decision-making process to make Group Decisions on Big Issues:

STEP 1:	STEP 2:	STEP 3:	STEP 4:	STEP 5:	STEP 6:
Identify the problem or decision.	**Gather information and analyse.**	**Develop Decision Paper.**	**Meet, Debate, Decide.**	**Test and finalise decision.**	**Get approval, if required,**
› Is there a problem? › Is it worthwhile to solve the problem? E.g. costs vs. the benefits? › Allocate responsibility to drive the decision-making process.	› What do you need to know to be able to make a good decision? › Who can help you get the data?	› Identify most likely actions/ solution options to achieve desired results. › Identify criteria against which to evaluate options – ideally, results required and results to be avoided. › Analyse options against criteria Identify best option. › Identify what problems / challenges this option could create if implemented. › Identify how those would be addressed. › Draft decision paper.	› Circulate paper. › Meet, Debate, Decide. › Identify great 'soundboards' to test your thinking (Super Coach, Mentors, Advisors, Board, Investors and Friends who've gone through this before). › Agree and allocate actions	› Test your decision and reasons (send pre-read, then meet to discuss). › Debate internally again, if necessary. › Finalise decision	› If decision requires Board or Investor approval, follow required process to obtain approvals.

6. EXAMPLE DECISION PAPER

The example illustrated here is the same as per our example Board pack, in our 10X Boards tool kit. For the Option Analysis, the 'Situation, Complication and Resolution' framework (developed by Barbara Minto) is a very simple yet effective way to frame a problem and your analysis, to empower stakeholders (whether your Exco, or Board, or others) to participate effectively in a robust debate and decision.

Situation:

a) The Ruimsig area was identified as one of the top five targeted areas in Gauteng, per the board's strategic planning session earlier in the year;
b) The targeted school size is for 500 learners and we need a stand of between 15 000 m^2 to 20 000 m^2; and
c) We are able to invest up to R25m in Phase 1 of the school - that should cater for at least 300 children.

Complication(s):

a) We have identified two prospective new sites in the Ruimsig area. Each site has its own advantages and disadvantages and both meet most, if not all, of our evaluation criteria as approved by the Board. However, it is not clear which option is the best.

Key Question(s):

a) Should we acquire any of the two properties? If so, which one?

Options:

We have three options:

a) Acquire the Peter Road site;
b) Acquire the Hendrik Potgieter site; or
c) Do not acquire any of the sites.

Evaluation Criteria:

a) Is the land larger than 15 000 m^2?
b) In the case of existing buildings, are they easily convertible for our use?
c) Is it close to the major routes identified within the area?

d) Is it within a five-minute drive of any of the major estates identified in the area? For example, Featherbrooke, Eagle Canyon etc.?

e) Does it have the right zoning and rights in place? If not, is it likely we'd get it?

f) Is it at least 1km away from the main competitors identified in the area? For example, Maragon and Trinity House?

g) Is it a reasonable price? For land only, is it less than R500 per m^2 of land? For land and buildings, is the total cost (including all renovations) less than R7 500 per m^2?

h) Is our expected payback period less than 84-months (7 years)?

i) Do we expect the school to reach breakeven in less than 12 months at an 'Earnings before interest, taxes, depreciation and amortisation' (EBITDA) level?

j) Is the total expected Internal Rate of Return (IRR) of the investment more than 20 percent?

EVALUATION:

The table below illustrates the evaluation of both opportunities against the pre-defined criteria for the area that was agreed at the board's annual strategic planning session.

CRITERIA:	WEIGHT:	OPTION 1: PETER RD		OPTION 2: HENDRIK P.	
Advantages:		Close to Eagle Canyon Estate. Eagle has more than 2 500 residential households. 75 percent of these earn more than R1m p.a. Large land size of 25 000 m^2 should allow for easy expansion. Limited competition in the area.		Close to the Featherbrooke and Hazeldene Estates. Total number of households that earn more than R1m p.a. is 2 250 within a 3km radius. Rights in place. Moderate competition in the area. It is located 2km from Maragon. However, Maragon is at its max capacity and has limited expansion opportunities. Total cost for 500-child school c. R20m.	
Disadvantages:		Land is priced at R650 per m^2. That is R150 more than our approved budget. It is further complicated by the fact that it is a 25 000 m^2 stand. Total cost for a 500 child school would be ~R27.5m. It would need to be rezoned. However, we are confident that we will receive the rights.		It has an existing building of 1 750 m^2 that can be converted to Phase 1 of the school. However, the building is not ideal. We can only start refurbishment in July 2016, which means we will only have 6 months before we open in 2017.	
1. Is the land larger than 15 000 m^2?	15%	5 / 5	Yes. It is 25 000 m^2.	3 / 5	Yes. It is 17 555 m^2.
2. In the case of existing buildings, is it easily convertible for our use?	10%	5 / 5	N/a	3 / 5	Expected cost of R3 350 per m^2.
3. Is it close to the major routes?	10%	4 / 5	Yes. Refer to map attached	5 / 5	Yes. Refer to map attached.
4. Is it within a 5-minute drive of any of the major estates?	5%	5 / 5	Yes. Refer above	4 / 5	Yes. Refer above.

CRITERIA:	WEIGHT:	OPTION 1: PETER RD		OPTION 2: HENDRIK P.	
5. Does it have the right zoning and rights in place?	5%	3 / 5	No. But 90 percent confident we'll receive the rights.	5 / 5	Yes. For 750 learners.
6. Is it at least 1km away from main competitors identified in the area?	5%	5 / 5	Yes. Closest competitor is Cambridge College which is located 3km from the site.	3 / 5	Yes. Closest competitor is Maragon which is located 2km from site.
7. Is it a reasonable price? For land only, is it less than R850 per m^2? For land and buildings, is the total cost included all renovations, less than R7 500?	10%	2 / 5	No. Cost is R650 per m^2. Total cost will be R27.5m.	4 / 5	Yes. We will be able to build the school for R20m.
8. Is our expected payback period less than 84m?	10%	4 / 5	Yes. 80 months.	5 / 5	Yes. 78 months.
9. Do we expect the school to reach breakeven in less than 12 months at an EBITDA level?	10%	5 / 5	Yes. In 6 months.	4 / 5	Yes. In 12 months.
10. Is the total IRR > 20 percent?	20%	4 / 5	Yes. It is 22 percent.	4 / 5	Yes. It is 21 percent.

The weighted average scores per our evaluations are 4.25 / 5 for the Peter Road site and 4 / 5 for the Hendrik Potgieter site. The evaluation above is therefore not conclusive.

RECOMMENDATION:

The CEO and his senior team recommend to proceed with the acquisition of the Peter Road property. Reasons include:

- It meets most of the criteria;
- It is expected to generate a 25 percent IRR over a 10-year period. That is higher than the Hendrik Potgieter property. One of the reasons is that we expect to attract a higher price premium due to the location and the fact that the school will be custom built (as opposed to a revamped existing site);
- It has the ability to easily grow to 1 000 learners, more so than the other site; and
- We can start construction by Q4 of 2015 and hence we will have more time to complete the school before the opening date of 1 January 2017.

Decision Required:

Please approve the acquisition of the 25 000 m2 for R16.25m and the construction of Phase 1 for an additional R11.25m.

Appendices:

Below is a list of supporting appendices to help empower the Board in its decision-making process:

a) Capital budget per option;
b) Designs per option;
c) Map of location of each site;
d) Financial analysis of each option; and
e) Townplanner's report of each site.

Appendices A: Capital Budgets

1

Option 1: Peter Rd

Peter Rd:			
Item	**Rate:**	**Qty:**	**Total:**
Land	R 650	20 000	R 13 000 000
Internal roads & services	R 250	2 500	R 625 000
Buildings	R 4 000	2 500	R 10 000 000
Synthetic grass	R 750	350	R 262 500
Play equipment	R 7 500	15	R 112 500
Fencing & security	R 1 250	250	R [illegible]
Signage	R 10 000	1	[illegible]
Entrance gate	R 50 000		
Landscaping	R 50 000		
Professional fees	R 350 000		
Municipal costs	R [illegible]		
Sundry fees	R [illegible]		
Contingencies	R [illegible]		
Total			[illegible]500

2

Option 2: Hendrik Potgieter Rd

Hendrik Potgieter Rd:			
Item	**Rate:**	**Qty:**	**Total:**
Land	R 500	17 555	R 8 777 500
Internal roads & services	R 250	2 500	R 625 000
Buildings	R 3 350	2 500	R 8 375 000
Synthetic grass	R 750	350	R 262 500
Play equipment	R 7 500	15	R 112 500
Fencing & security	R 1 250	500	R 625 000
Signage	R 10 000	1	R 10 000
Entrance gate	R 50 000	1	R 50 000
Landscaping	R 50 000	1	R 50 000
Professional fees	R 350 000	1	R 350 000
Municipal costs	R 150 000	1	R 150 000
Sundry fees	R 50 000	1	R 50 000
Contingencies	R 50 000	1	R 50 000
Total			**R 19 487 500**

Note: The example here is illustrative. In the real world we'd expect to have more detailed capital budgets etc.

The cost of development of phase 1 for 300 children will be R5m higher for the Peter Rd. option. It is due to:

- Higher cost of land: R650 vs. R500 per m2;
- Larger land: 20,000 m2 vs. 17,555 m2; and
- Higher build cost: We expect to need R4,000 per m2 to build the school. However, for the Hendrik Potgieter option we estimate a total cost of R3,350 will be sufficient to acquire and refurbish the existing buildings

The 2,500 m2 covered buildings should allow for 8.33 m2 per child which exceeds the required minimum of 5 m2. It includes administrative buildings as well

[DECISION # 5]:
New site 2017

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Appendices B: Designs

Note: The example here is illustrative. In the real world we'd expect to have designs for both options and 3 dimensional illustrations of the concepts

[DECISION # 5]:
New site 2017

60

Appendices C: Map of location(s)

[DECISION # 5]:
New site 2017

Appendices D: Option Financial Analysis

Key Inputs:

Input:	Peter Rd.	Hendrik Potgieter.
Revenue	• Ramped-up to 500 children in 5 years • Prices charged at R3,750 per month	• Ramped-up to 500 children in 6 years • Prices charged at R3,500 per month
Capital costs	• R25m for phase 1 for 300 children	• R20m for phase 1 for 300 children

Key Outputs:

Option 1: Peter Rd

Cash Flows:	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Cash flows to investing activities	-R25 023	R 0	R 0	-R 5 850	R 0	R 0	R 0	R 0	R 0	R 0
Cash flows from operations	R 1 250	R 2 500	R 3 500	R 4 500	R5 500	R 6 500	R7 500	R 8 500	R9 500	R 10 500
Sale of assets	R 0	R 0	R 0	R 0	R 0	R 0	R 0	R 0	R 0	R 42 000
Total	**-R 23 773**	**R 2 500**	**R 3 500**	**-R 1 350**	**R 5 500**	**R 6 500**	**R7 500**	**R 8 500**	**R9 500**	**R 52 500**
Cumulative	**-R 23 773**	**-R 21 273**	**-R 17 773**	**-R 19 123**	**-R 13 623**	**-R 7 123**	**R 378**	**R 8 878**	**R 18 378**	**R 70 878**
IRR	22%									
Payback period	80 months									

Option 2: Hendrik Potgieter Rd

Cash Flows:	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Cash flows to investing activities	-R19 488	R 0	R 0	-R 5 850	R 0	R 0	R 0	R 0	R 0	R 0
Cash flows from operations	R 1 000	R 2 250	R 2 750	R 3 500	R 4 500	R 5 500	R6 500	R 7 250	R7 750	R 8 250
Sale of assets	R 0	R 0	R 0	R 0	R 0	R 0	R 0	R 0	R 0	R 24 750
Total	**-R 18 488**	**R 2 250**	**R 2 750**	**-R 2 350**	**R 4 500**	**R 5 500**	**R6 500**	**R 7 250**	**R7 750**	**R 33 000**
Cumulative	**-R 18 488**	**-R 16 238**	**-R 13 488**	**-R 15 838**	**-R 11 338**	**-R 5 838**	**R 663**	**R 7 913**	**R 15 663**	**R 48 663**
IRR	21%									
Payback period	80 months									

Note: The example here is illustrative. In the real world we'd provide more detailed assumptions and outputs in evaluating the outputs

[DECISION # 5]:
New site 2017

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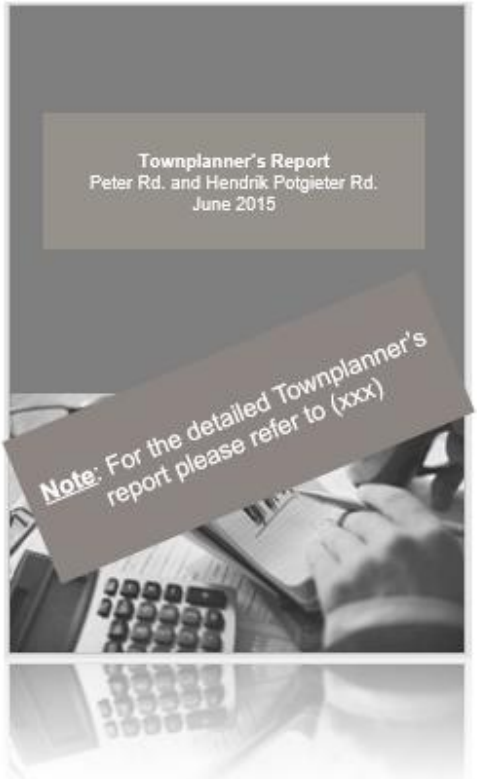
Appendices E: Townplanner's Report



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[DECISION # 5]:
New site 2017

7. DECISION PAPER TEMPLATE

The table below is a template that can be used to table a set of options to the decision-making forum (whether Exco, Board, Investors, or other).

SITUATION:
[Insert a description of the situation. It should establish a certain context (e.g. time, place, event etc.) that the reader can relate to]
COMPLICATION:
[The complication will illustrate a certain problem(s). It should create a relevant issue, a sense of urgency and a compelling reason to listen or even act]
KEY QUESTION(S):
[Each complication should translate into a key question. These questions will be the basis for the rest of the decision paper]
OPTION(S):
[Please insert a range of options on how to solve the challenge identified above]
EVALUATION CRITERIA:
[Define the criteria against which the options would be evaluated. In other words, how will we decide which option to select?]
EVALUATION:
[Evaluate each option against the defined criteria to assess which option is the best. For simpler decisions a list of pros and cons could be sufficient']
RECOMMENDATION:
[Insert the recommendation. The recommendation should answer 'How' the problem will be solved]
PLAN:
[Insert the course of action in the event the decision is approved]

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