

beyond... the mbh newsletter

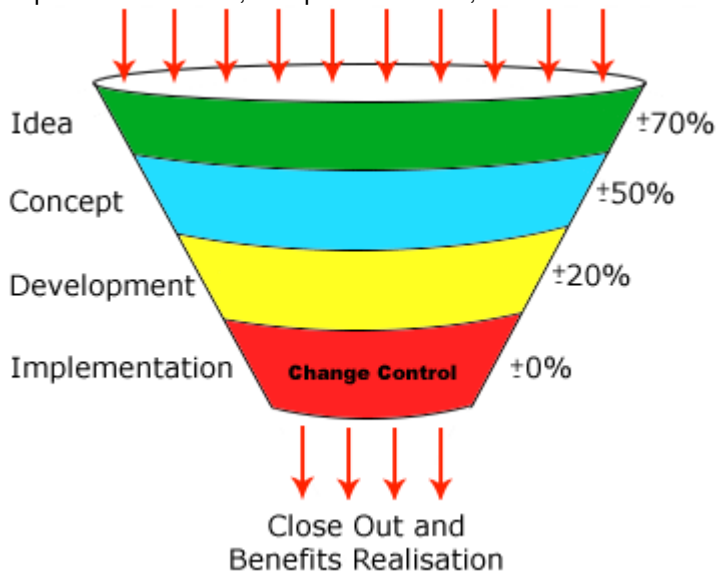
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Editor's note

Over the next three months we will be featuring a series of articles on stage gate financing. A properly implemented stage gate process can add millions to the value of the top 100 listed Australian companies. This first article will look at the process of stage gate financing and the objective of each stage in the process.

Stage gate financing

The concept of stage gate financing is centered around the need for companies to be agile and able to quickly capitalise on changes in market demands and dynamics. Stage gate financing is basically where a project is assessed and investment approved to take the project to the next stage in the delivery process as apposed to approving a project in its entirety and assuming that it will actually be completed. To do this, companies should;



- 1) Have an ideas database that requires the idea generator to articulate the concept, put forward potential benefit outcomes or objectives of the idea and to justify that idea in terms of the companies current strategic direction and vision;
- 2) Invest in a large number of these ideas as seed investments for concept phase only. The key deliverable being a business case that quantifies the qualitative argument put forward in point one above;
- 3) Constantly update and monitor this portfolio of ideas while investing further capital in the planning and development of those ideas that have the greatest potential to add value as measured by their Net Present Value and call option value;
- 4) Update the business case as an exit criterion for projects wishing to have the "Go button" pushed and to execute those projects

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efficiently and effectively. It is essential that projects that get to step 4 are delivered within 20% of the timeframe and budget estimated at point 3 above (note that this could be significantly different to the timelines and costs estimated at both steps 1 and 2 above).

5) Actively realise the benefits of the initiatives that are delivered including looking for upside options that would require further investment and downside loss mitigation on those projects that weren't as good as estimated when the "Go Button" was pushed. To do this it is essential that project teams are allowed to work with the BAU area impacted after the "Live Date" or "Launch Date" of an initiative. Most value currently being generated by a company should be through the realisation of benefits from projects that have already been implemented. Any incremental investment in the close out and benefits realisation phase must have a strong NPV as the costs to get to that stage are sunk....This in financial markets is commonly seen as leveraging your investment.

A properly executed stage gate process will lead to a properly executed portfolio approach to business. One investment leads to the next investment as companies maximise the value of the first investment. This maximises the company's current valuation which is always equal to the realisable value of past investment decisions plus the options they create for future investments.

In the next newsletter we will talk about how option pricing on real assets can not only assist with the strategic valuation of a project but can also tell you how much to invest to get to the next stage.

You can find out more about mbh and stage gate financing at

www.mbh.com.au