**Improvement Opportunities**

How does management identify improvement opportunities?

The primary role of any firm’s management team is to increase shareholder value. This could take the form of increased profits and/or increased share value, increased dividends, or a combination of both. To improve these metrics, a firm’s management team should continually seek opportunities for improvement. Examples of improvement initiatives might include the following:

1. Launching an advertising program to attract more customers

2. Purchasing productivity enhancing equipment

3. Hiring additional skilled employees and/or providing in-house training

4. Adopting the latest technologies throughout the company

While there may be subjective reasons for choosing one opportunity over another, there is usually a way to dollarize, or put into financial terms, the benefits of a new initiative. Even investments like safety equipment can frequently be justified via cost avoidance of injuries, workmen’s compensation, and lawsuits.

How does management prioritize opportunities?

When the management team considers a list of opportunities facing it, the frequent reaction is to try and implement all of them. On the surface, this may appear as a good idea, but there are usually financial, time, and people constraints that preclude all of the opportunities from being pursued. Therefore, a method of prioritization must be used. The most common method of prioritization is to evaluate the financial benefits versus the financial costs.

Consider the following examples:

Project 1 has a cost to implement of $10,000 with a financial benefit of $800; therefore, the ROE for Project 1 is 8%.

Project 2 has a larger financial benefit of $5,000, but the cost to implement is also larger at $50,000. This provides an ROE of 10%.

Project 3 provides the best return of equity at 15% based on a $44,000 cost to implement and a financial benefit of $6,600.

Project Costs to Implement Financial Benefit ROE\*

1 $10,000 $800 8%

2 $50,000 $5000 10%3 $44,000 $6600 15%

\*ROE = Financial Benefit / Cost to Implement

In real life, it is rare that all other considerations are equal. Projects may differ in their relative risk, the time needed to accomplish them, the management time needed to accomplish them, initial investment and ongoing costs, and a host of other issues.

Dollarizing Opportunities

To assign a dollar value to the financial benefits, you must identify the direct financial benefits that a particular project will achieve. The direct financial benefits will be determined over the life of the project or a maximum of 5 years, whichever is shorter.

Home Run or Singles

An important decision a firm's senior management must make is whether to go after home runs or singles. Home runs are large-scale, expensive, risky projects, while singles are easier to complete, lower risk, smaller projects. The senior managers must take the following into account when making this strategic choice:

A large project will tie up management for an extended period of time and may preclude it from focusing 100% on its daily routine issues.

Larger projects (home runs), by their very nature, are usually higher risk. This is because they may affect many parts of the firm, both after the implementation as well as during the implementation. The dollar magnitude of costs involved in larger projects may preclude routine spending requirements needed to run the business.

Low Hanging Fruit

Low hanging fruit is even easier to achieve than singles. Low hanging fruit projects are easy savings opportunities that are low risk, require minimal investment, and have lower time requirements of management.

For example, if a new color becomes fashionable, a consumer product firm can capture greater market share simply by changing the color of the product. This is considered low hanging fruit because it is low risk, requires little management time to implement, risk, requires little management time to implement, has a low cost, and the return is attractive.