

Imperatives in Unstructured Strategic Investment Decisions

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Abstract

We need to study strategic investments as they result in significant and irreversible decisions. Strategic investment decisions result in activities that are meant to profoundly change the direction of an entity after assessing the risk levels, financial investment levels and internal capacity levels. In summary, the entity looks within itself to identify its long-term plans, internal capabilities, risk appetite, and financial resource availability, looks outside to see what prospects are out there that it can adopt or attain, and leverages its internal configuration to attain its objectives.

The authors distinguish between investment decisions that are operational and strategic.

Operational decisions are routine financial application decisions that sustain the business on its existing trajectory while strategic investment decisions are tied to the mission of an organization. The authors, further, note that capital budgeting techniques were structured investment decisions while strategic investment decisions were unstructured. As opined by Mintzberg et al. (1976) strategic investment decisions are unstructured and require IDS model to execute. The “IDS” model required identification, development and selection of the strategic investment decision.

In making its decision, an entity uses a variety of tools at its disposal, it does not need to use necessarily one tool for all decisions. In the past, preference has been given to simple financial methods but more complex financial techniques have gained traction with the availability of information processing tools such as spreadsheets. There is a need to, also, consider organizational and behavioral aspects of decisions that have not received as much attention despite their importance.

It is imperative that strategic decision-making does not choose the path of least resistance to use information that is only readily available and forsakes equally important considerations. If the path of least resistance is chosen, we may very well end up with poor decisions that result in significant unsustainable losses of scarce resources resulting in wealth being destroyed rather than being created. The destruction of wealth will result in income inequalities and communities being unable to achieve life's aims with the consequent disruption of civilizations such as what we see happening in the Mediterranean where many die to cross to better lives in Europe using inadequate means and mass demonstrations decrying failed states when the populace can't provide basic necessities for families and make ends meet.

What is known at the moment is that financial considerations trump all others while the effect of management intuition and non-financial considerations don't receive as much attention. What is not known is how investment decisions find a way of integrating non-financial behavioral considerations in investment decisions.

We posit that a gap exists in making strategic investment decisions that utilize both financial and behavioral aspects. This demonstrates that there is a gap which can be bridged by focusing on all aspects of an investment. The methodology employed in this paper desk study reviews.

Keywords: strategy, unstructured, decision, financial, behavioral

Introduction

Mintzberg, Raisinghani, & Theoret (1976) clarify strategic unstructured decision processes have the components of a decision which is a conscious pledge to direct resources in a certain endeavor, a strategic focus indicating importance, a decision process that comprises a series of activities that commence once a need has been identified and ends once the commitment is in place and a lack of structure that makes it novel with no precedent of how it has been handled in the past thus requiring further study before reacting. Mintzberg et al (1976) recommend eight steps which are Recognition, Diagnosis, Search, Design, Screen, Analyse, Evaluate Decision Control And Choice and Authorization.

According to Alkaraan (2015), investments can be one-time or repeating/versatile, with predictable or unpredictable outcomes, isolated or interlinked with existing projects or have varying time horizons. However, all capital investment decisions fall either in the operational or strategic category and must use suitable appraisal methods and decision-making processes called capital budgeting. The operational type such as the replacement of existing assets that are in current processes with the objective of sustaining normal operations at the same level with potential outcomes and pitfalls well understood can be handled using programmed or routine decision-making procedures. However, the strategic types such as mergers and acquisitions have the characteristic of being non-programmed (there are no previous examples to learn from), substantial (require a sizeable resource commitment), complex (require diversified talent coordination, affect multiple areas in the entity ranging from research and development to production and marketing), long term (focused on long term performance and goals), competitively orientated (intended to radically shift the entity's current situation), uncertain (impact can not be easily tabulated and quantified so decisions may have to be made in the dark) and subjective (affected by the predispositions of decision makers) (Alkaraan, 2015).

Northcott & Alkaraan (2006) lament the inconsistent findings in capital investment decision-making practice where little distinction is being made between strategic and non-strategic (operational) evaluation methods and the marginal effort on the use of emergent analysis techniques for strategic investment appraisal. The authors further summarize their position by pointing out that there is not much agreement in the scholarly community on which conventional investment analysis technique(s) is(are) effective, traditional investment appraisal methods have shortcomings, and that efforts have been made to merge financial and strategic analysis in the balanced scorecard, real options analysis, value chain analysis, benchmarking and technology road mapping techniques.

Northcott & Alkaraan (2006), citing the work of Mintzberg et al. (1976), Butler et al. (1991), Accola (1994), Slagmulder et al. (1995); Van Cauwenbergh et al. (1996), Slagmulder (1997) provide typical examples of strategic investment decisions as mergers and acquisitions, introduction of new product lines, new manufacturing processes, advanced manufacturing and business technologies and shifts in production capability. Alkaraan (2015) focuses on mergers and acquisitions and points out that a range of decision-making approaches ranging from "rational economic" to "incremental adaptive" has to be used in addition to a variety of analysis tools in strategic investment decision-making. The author describes such decisions as a Chief Executive Officer's greatest challenge as successful decisions will permit the firm to benefit from significant strategic and operational advantages and further clarifies that strategic investment projects require significant funding, have a long-term impact on corporate performance, are risky and result in intangible outcomes that are hard to quantify.

Pre and post-decision control mechanisms are important features in strategic investment decision making according to Alkaraan (2015). Northcott & Alkaraan (2006) observed conventional investment analysis techniques such as the payback period, return on assets or investment, internal rate of return and net present value, and risk analysis approaches such as sensitivity analysis and adjustment of the payback period or discount rate have been widely examined and used in both strategic and non-strategic investment projects in several studies with markedly varying findings.

After pointing out that the variations may be due to the different research methodologies adopted in terms of different populations, sample sizes and types of questions used in respective studies, the authors refer to research that points to a decline in the use of more sophisticated methods with the payback method as the most popular means of assessing risk in advanced manufacturing technology investments while in contrast another research points to the use of sensitivity analysis and multiple methods for a single appraisal with discounted methods such as net present value and internal rate of return being adopted. Alkaraan (2015) asserts that the discounted cash flow investment evaluation techniques such as net present value and internal rate of return can be easily used with the advent of information technology tools such as spreadsheets and have drawn the attention of researchers and academicians to equally important organizational and behavioral aspects of decisions not receiving as much attention. As an example of pre-decision controls, the author identifies factors such as organizational strategy and operating objectives; personnel involvement; approval procedures, financial evaluation requirements; established hurdle rates, authorisation levels, and managerial intuition. Kahneman & Tversky (1979), in proposing prospect theory, as an alternative to the expected utility theory which assumes rational investors, point out that decision-makers prefer to minimize losses rather than taking additional risk for unproven gains. In their argument, the authors explain the certainty effect where investors are seen to be risk averse where gains are guaranteed as opposed to risk-loving when losses are highly probable and the isolation effect where investors are unwilling to rely on information that is available in the public domain.

Even though it may come too late in the process, post-decision controls such as monitoring systems that identify departures from original estimates provide feedback that informs managers of what their experience was, increase their analytical capacity and cements their learning by enhancing their judgment capacity so future decisions can be undertaken smoothly (Northcott & Alkaraan, 2006). According to Alkaraan (2015), judgment will play a significant role in strategic investment decisions, especially in firms that operate in high-tech, dynamic and/or highly competitive environments and insists financial analysis can not be the only determinant as disregarding either will make decision-making less effective.

Conclusion

Strategic investment decisions, to be successful, have to consider both financial and non-financial factors. There is an indication that the easy-to-use, non-discounting, financial methods have been more prevalent in use but there is also literature to support discounted methods. There is also surprising evidence that despite the differences in complexity, risk levels and potential impact of strategic and non-strategic decisions, the same techniques are being used. Regardless, strategic investment decisions will require the use of both financial analysis and judgment to ensure success. Finally, the prospect theory informs us that the decision maker is likely to review the financial factors with the potential bias to minimize losses rather than taking on additional risk for profits that are not yet proven. This identifies further scope for strategic investment decision-making models to focus on ensuring behavioral biases at the individual level do not permeate organizational decision-making processes thus potentially resulting in a disregard of investment opportunities that can yield significant positive results within acceptable risk levels.

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