Investment Evaluation Factors, Investment Evaluation and Investment weighing Methodology

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As we in Iran are moving increasingly towards an open market economy with our industry having succeeded in providing many market needs in terms of goods and services the future criteria is no longer "the lack of goods and services" but " better marketing for the goods and services coming on line" in a more developed economy.

This requires the use of professional business and evaluation tools if we are required to compete with goods and services of other countries in order to export and efficiently satisfy our internal market.

The summary of the three stages of investment and business evaluation are examined. These are as follows: Investment Evaluation Factors, Investment Evaluation and Investment weighing Methodology.

Investment Evaluation Factors

These are a mix of factors that affect the decision making in an investment, they are:

1. **The investment policies**
2. **The business case (and it's Pitfalls)**
3. **The business plan (and it's Pitfalls)**
4. **The investment constraints**

1. The investment Policies

These are the policies which are particular to the investing establishment and maybe different from one establishment to the next depending on their aims and situation. It maybe that one establishment is from the public sector with some social/economic designs or from the private sector which is profit oriented.

All establishments have to consider and decide on the following:

- The required market growth rate for an investment.
- The minimum and maximum investment.(Depends on the economic situation of the establishment and it's mission).
- What is the preferred range for investments? (Considering the establishments' mission and specialization i.e. The IT sector for IIDCO)
- The preferred form of involvement. (Sole investor, minority investor, Lead investor)
- What is the investment method? (100% equity or a mix of Debt/equity?)
- What is the exit strategy? (Less than 3 years, for most private sector investors or 3-5 years? Or 5-10 years, as the case in R&D businesses cases, incubators and the like.)
- What is the preferred ROI (rate of return on investment)?

2. the Business case

A business case is organized around an action or a decision and its alternatives. Also what this action is meant to accomplish by way of its objectives. It is based on a **cost model** and a **benefits rationale**, designed for the case, and applied to one or more action scenarios. A business case has measurements and **Financial metrics** such as NPV, IRR, ROI, payback period, , based on projected cash flow. Also includes important **non-financial impacts**.

In a non-profit or government organization The scope of the case may include benefits and costs **to the population served** as well as the organization itself.

All in all the business case must meet or fit the policies of the investment establishment in order to be considered for investment.

The pitfalls that investors should consider in any business case are:

- Single purpose use of the product or service that may constrain marketing and sales of the business.
- The business case revolves around a single person commitment.
- Unworkable documents (incompatibilities in the actions and results documented)
- Unbalanced application
- Too action oriented
- No performance standard
- Poor progress control
- Early consumption (too dependent on fashion or the current trend)

3. The business plan

It is organized around an **organization** or the whole enterprise. The plan may cover a single product or product line or the whole organization. It predicts **business performance** of the organization, especially in the main categories of the income statement. This may include projected pro-forma income statements or balance sheets for future years. The business plan focuses on business **objectives** for the **organization.**

It is based on The **business model** for the **organization** (showing where and how the company makes money, similar to income statement), as well as expected trends, competitor actions, etc. The business plan measures **business performance** in terms such as sales, margins, profits, and business **"health"** by contributions to important balance sheet categories.

Business Case vs. Business Plan: the Difference?

With all the focus on ROI and business case accountability today, many people are confused about the difference between the business case and the business plan. Business case and business plan tools are complementary, but different.

Even those with a strong background in analysis or business planning sometimes have to ask: "What's the difference between a business *case* and a business *plan*?
It's a question you may have to answer many times for your colleagues and management. People often use the terms inter-changeably or ask for one when they mean the other. Both support decision making and planning and both project business results forward in time. They are complementary, but they different.

Before you set out to build a business case or build a business plan, or before you ask someone to bring you one or the other, be sure that everyone involved understands clearly what is expected.

It's About the Action, it's About the Organization

In a nutshell, a business case is organized around an *action*, while the focus of the business plan is the *organization*.

Use the business case to answer "What happens if...?" questions like these:

- What are the financial consequences if we choose this proposal or If we choose that Proposal?
- What will we need as a capital budget next year if we decide to buy the service vehicles instead of leasing them?
- Is the investment in new technology justified? Is there a positive ROI?

Use the business plan to answer "What will the business look like....?" questions like:

- What sales, margins, and revenues can we expect next year?
- What will our balance sheet look like in two years, under the new strategic initiative? What will it look like in five years?
- How many years will it take this startup company to become profitable?

When deciding which tool you need, or when explaining the difference to someone else, consider the important differences that follow from the form focusing on an action as opposed to the organization:

A business case can support a business plan by helping answer questions like this: "How will the proposed marketing program (the action) impact our (the organization's) business performance.

A business plan can support a business case by helping case developers estimate costs and expenses, revenues, and expected changes in these areas.

5. Investment constraints

These are the constraints, maybe they be political, geographical or economical, in which the establishment operates. These constraints may pre-determine how or where or in what way the investment establishment operates. For instance:

- Geographical or geo-political constraints could predetermine where the investments can be made. An investment company based in EU is less constrained than an investment establishment in Iran.

- The economic environment does have constraints put upon the investing establishment. The banking or the capital market are good examples. Also special trade laws or arrangements could facilitate or constrain investment activity

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- Conflicting interests of the investment group or establishment may restrain an investment decision or stop it altogether.

- The economic backing of the investment company plays a crucial role by determining the maximum and minimums of investments together with the frequency or form of investments the establishment is able to exercise.

<u>Business Evaluation</u>

The evaluation of the business opportunity is an integral part of the investing process. It is a business health check. This consists, mainly, of the following sub sections:

- The financials
- The market
- The management team
- The process
- The product
- The risk

1. The financials

The financials have to adequately explain the following:

- Cash flow projections
- Breakeven analysis
- Balance sheet
- Incomes in the profit &loss projections
- Sources and application of funds
- Capital expenditure plans

It must be said that each topic could be dealt with in depth and could a topic for lengthy examination, with their own particular examples.

All in all the financial must correlate with the rest of the business, its plans and forecasts.

2. The market

The ideal situation would be an investment in a company whose products or services were to serve and establish a new or greatly expanded market supporting the development of a large public company.

The evaluation of a market analysis should include the following:

- Industry analysis
- Competition analysis
- Market size analysis
- Market growth analysis
- Segmentation and sales targeting
- Pricing rational
- Distribution
- Product forecasts

3. The management team

Again the ideal situation where an investing establishment wishes to invest is in safe hands of an experienced and motivated management team with a clear vision and a well articulated strategy for executing its business model. The points to look for in a management team are as follows:

- Well defined roles and responsibilities of principles
- The teams background and experience
- Alliances and partnerships
- The ability of the team to attract first class people
- The creative talent of the team
- Does the team understand “business focus”?
- Is the team able to build a successful company?

4. The process

The process of the business should be stated clearly in the proposal or the business plan. The analyst should evaluate the following:

- The process in the raw ingredient supply
- The added value process
- The quality control process
- To process leading to economies of scale
- Is there a mission / vision / goals and objectives ?
- Business strategy logic

5. The product or service

The product or service is evaluated for the level of its development and future potential

- New or different product?
- What is the level of development and its potential?
- Is the product on the market? Are there competitors?
- If the product is new has it been tested on the market?
- If the product has been tested internally , in the company?
- If the product is in the development stage (in case of incubating investments) how long till it becomes available on the market?

6. The Risk

There are two parts to assessing risk. First is evaluating risk to the investing establishment. Second is risk evaluating assessment of the proposing company of itself together with its plans on how to deal with such circumstances. Risk evaluation assesses all other business areas for weaknesses and possible threats. These include:

- Technological effectiveness
- Availability of vendors and supplies
- Quality of leadership and management
- Competitive environment
- The extent of market adoption of the company's product or service
- Commercialization
- Scalability
- Quality
- Cash flow