COLLEGE OF ACCOUNTING

MANAGEMENT ACCOUNTING | INTERMEDIATE

Video Transcription: Management Decision-Making: Qualitative Factors – Part 1

Hi, my name's Paul and I'm excited to be talking about management decision-making qualitative factors with you. You're probably a lot more familiar with the quantitative factors, those are the numbers, which could involve relevant costing, capital budgeting, valuations. This is where you collect all the numbers and you try and use those to make a decision. Those are incredibly important and you need to be accurate and you need to understand what each step means, and how that information can help you.

What I want to do in this video though, is equally important, but a little bit harder to grasp and those are the qualitative factors. This is how your decision impacts other people's' experience and other people's enjoyment of the product or the service that you provide.

These are very important, but can be ignored by number-crunchers that just focus on what the spreadsheet has to tell you. That would be a big mistake when you are asked to comment or recommend or to suggest an action for management. But more than that, it could be a massive area of weakness as you go out into the business world if you're not familiar with these very important factors when making a decision.

I have the privilege of lecturing the MBA class here at UCT and in the class you've got different people who have had different working experiences and I want to use a couple of stories here just to illustrate to you that your decisions need to be based on more than just the numbers. The first great story comes from a student that used to work at Harrods in London; you know that fancy department store that everyone likes to visit when they're there.

They made a decision based on the spreadsheet that made sense. Instead of having delivery vehicles go out from Harrods every day to drop off people's couches, they saw that it would be more cost effective to outsource the delivery function to a courier company. Oh my goodness, whilst that made sense on the spreadsheet, customers were incredibly unhappy. And the major reason was that when the couch was delivered to their apartment in London no one could see that it was from Harrods. The van that was green and had its gold lettering was nowhere to be seen as the couch was delivered in a white, nondescript van. Customers were very upset and Harrods had to quickly reverse their decision.

It made sense from a numbers point of view but the qualitative factors – what customers really valued, which was that their neighbours saw exactly where their couch came from – wasn't included in the spreadsheet and it should have been.

Another great example coming from the class related to someone who had experience in the car industry. Making cars is a long process and everyone tries to be on budget at each part of that process. But generally they sneak over and so as the project goes on the car becomes more and more expensive and more over budget.

The final process of putting the car together is the interior. It's left till last because obviously damage done here is much more likely because it's a soft environment. Well guess where they wanted to make all the cuts when it came to costs? Well, it had to be made right at the end because everyone had gone over budget and so to bring this whole project in they made dramatic cuts in the interior of the car.

He asked us as a class, where do drivers spend 100% of their time? And the answer is, inside the car. But that's where the car manufacturers had made their biggest cost savings. And so the environment would typically be quite cheap and things would fall apart and the customer experience was much lower than what anyone had wanted. How did you end up in this position?

Well, the numbers were prioritised and because they'd gone over budget during the whole process, in order to hit the numbers they had to make dramatic cuts right at the end. Who was the big loser? It was the customer who had a poor experience of the car because the interior was underwhelming.

I could keep going but the third story comes from Apple. Steve Jobs, who I'm sure you've heard of, was quite a leader and he believed that music should be available to each and every person in a nicely small, portable format.

He was presented with an iPod that had taken many, many years to develop and when he held it in his hand he still said, this is too big, this is too big. But his designer said to him, "No, no, no Steve, this is the best we can do and considering the cost this is as small as it can go". Steve Jobs famously stood up, walked over to a fish tank that he had there and he dropped the iPod, the only one that actually existed in the world at the time, into this fish tank. Everyone was shocked and bubbles slowly started to emerge to the surface and Steve Jobs pointed at the bubbles and said to his team, "You see guys, there's air in the iPod, that means there's still space, that means it can still get smaller.

It's incredible, he threw away thousands of dollars' worth of equipment because he knew it was about more than just the numbers, it was about the customer experience. It was about making sure your music could be in a nice format that was easy to carry around with you. We all know that the iPod that was eventually delivered to the world was unbelievably successful.

I've told you about Harrods, I've told you about the inside of cars, I've told you about Steve Jobs obsessing about the customer experience regardless of the costs that would accumulate. All of these examples are meant to show you that it is more than just the numbers that should determine management's decision-making.

What I'm going to do now is, I'm going to go into some specific ways in which you can get better at answering questions that require you to think along the lines of more than just the numbers. I've got four specific things that I think will help you get better at those questions that ask you things like assess or recommend or identify a risk or give suggestions to management.

These are four things that I think will help you answer those kind of questions.

So the rest of this part one video is going to make one important point about qualitative factors. Then you're going to want to watch the part two video which will wrap up this discussion, and also introduces you to the key ingredient behind long-term, good decision-making.

So, the first thing that I would really consider is that all stakeholders have different needs and these needs need to be taken into account. In other words, when you're making a decision, you've got to be thinking through people and how this decision will affect people. There are different groups and so what I would love to do is just fly through some of those groups and make you alive to the needs that they would have.

The first group I'd like you to consider are the investors, the people that have given up their money to get this company started. Of course, they're interested in getting a return on their investment (RoI). They're concerned about risks and not losing their money, and they might also have other needs like a regular dividend to come from the company in which they've invested. A little example here that I would give is related to Anglo America who, during the financial crisis in 2007, decided to cut their dividend.

A dramatic decision as far as investors were concerned because they'd grown accustomed to getting a steady flow of cash from Anglo. And when Anglo made that dividend decision I don't think they fully realised how upset shareholders would be. There was more than just the numbers there, they needed to know what shareholders expected in order to avoid getting themselves into trouble.

The second group that I would consider is management. Now that might seem a little strange given that you are often management when you're needing to make these decisions. But what I want to point out is that sometimes management will have particular priorities for the life cycle that the company finds itself in at the moment.

So, a good example would be a company that's struggling for cash. That means that cash needs to be prioritised and every decision that you make needs to make sure that cash flow is brought into the company and not out of the company – it's a priority for that season. The other thing that I would emphasise is that management are often incentivised according to different metrics and so you need to remember what those metrics are and make decisions that are consistent with how management themselves are incentivised to perform.

The third group, which is of course very important are your customers. The examples I've given up until now have shown you just how important the customer experience is for someone at Harrods, someone driving a car and someone who wants to use an iPod. And so, you need to always balance how sensitive your customers are to the price that you want to charge them and to the quality of the product.

All of us have been customers of different companies and we'll know that we have different tastes and preferences and the company needs to take into account how customers interact with their brand, their service, their product and if the decision they're making will negatively or positively impact that relationship.

Besides your customers you've also got to take into account your suppliers. Who is it that's going to provide the goods and services you need to make a product or service available to your customers? Are you going to source your goods cheaply? That might be fantastic from a numbers point of view, but what could happen to quality? Should you now start to produce a product of inferior quality that breaks down more because you're trying to reduce wastage during the manufacture process ?

Again, there's a relationship here that needs to be considered. You might be winning on the price but losing on the quality and you need to decide where best your company can make that trade off.

I often use the example of Woolworths and PEP. Two companies that are operating in similar spaces, being retail, providing clothes to people. Woolworths have made it quite clear that quality, long lasting goods is what they want to produce. Whilst PEP probably have said everyday low prices is their priority. The customers will be attracted to those different brand propositions and you might go to Woolworths's Facebook page and see complaint after complaint about quality but you'll be unlikely to see that at PEP as more and more people realise the value proposition here is related to price and not necessarily the same quality that Woolworths has promised.

So, again, when you're taking these factors into account it's not one size fits all. You've got to look at the particular brand and the promise that they have made to their consumers.
Another very important group of people that you must never forget about are your employees. How will they be impacted by this decision? Are you requiring them to work long hours? Are you taking ideas that they've provided and rejecting them? What will the decision you're making do to the morale of your workforce?

In South Africa we need to be familiar with the influence of trade unions and various bargaining councils that exist. And we need to make sure that we make decisions that are within the legal framework of our country. Employees are so important and they need to always be considered when making decisions. I would also say that the government is an incredibly important player when it comes to making decisions in South Africa. Are there regulators that need to make sure that you're staying within the laws related to telecommunications companies or labour, for instance? What about SARS as the collector of revenue? Have you made sure that you've complied with the tax standards? The decision that you're making, is it consistent with the spirit and the law of our land?

Besides government, don't forget that you'll have a whole bunch of other stakeholders that will be watching you closely. Community leaders, environmental lobbyists, people that are concerned with more than just the impact you have in the income statement but the impact that you have on the environment and society at large. So that's just one important point you need to know. What you want to do now is click on part two and keep hearing about how best to consider Qualitative Factors.