

# The value of an investment is in its future, not its past



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“The value of an investment is not the historical cost thereof but the net future benefit to be derived therefrom.”

**T**his proposition is as valid in the world of IT decisions as it is in an economics or finance class. Given the potential impact of investment decisions, including those regarding the IT systems we employ, it may be worth briefly considering the elements to be addressed to determine this value. To do this the axiom may be expressed as a simple equation, as follows:

Investment Value = Value of Benefits – Relevant Costs  
(Note: For the sake of simplicity in the discussion the “time-value” adjustment is ignored. This should be considered in a real-life exercise.)

Where alternative investments are available, which is usually the case when considering IT solutions – for example the choice between a number of software packages – the equation should be solved for each option and, if we are to take a rational decision, the option with highest value should be selected.

## Choosing between alternatives requires comparison of equivalent benefits

Self-evidently alternate solutions should be evaluated on a like-with-like basis for this process to be reliable. When assessing competing packages the functionality available should be compared and, if required features are available in one package and not in the other, you should clearly factor in the cost of obtaining equivalent solutions. For example, if one application contains integrated document management, and this presents value to the user, and the second does not, the cost of providing this will need to be included to determine the true value of the second option.

## Determining benefits and costs

Key to the exercise is the determination of the benefits and the relevant associated costs. These will vary with each situation and it is not considered appropriate to try and address this in detail in this article. However, some general observations are useful:

### Value of benefits

- Firstly, value, like beauty, is often in the eye of the beholder and hence may not be easy to quantify.

However, within the context of a business investment decision you should at least be able to draw a relative or comparative value of the benefits between products. If you cannot ascribe a value to the benefits inherent in a solution you should question whether you make the investment or incur the expense at all! Secondly, functionality which is not used, or not going to be used, is irrelevant and should not have a value attached to it.

### Relevant costs

- Costs are perhaps easier to identify and should be the marginal cost associated with implementing the system to provide the benefits which have been valued. As with benefits, however, you should only include those costs which will be incurred.

### Distinction between cost and value

The above appears a perfectly logical mechanism to determine the appropriate investment decision and yet experience provides many examples where this is not applied. Human behavior is such that we often do not recognise the difference between cost and value and, in order to protect historical expenditure, continue to perpetuate investment which delivers a lower future benefit than the alternatives available. A common example of this is the reluctance of a stock market investor to sell a share when it is trading below original cost price rather than to take the current market value and compare that to the return which could be achieved on other shares.

Within the IT environment the inability to make this distinction (ie Cost v Value) manifests itself in a reluctance to move from legacy systems to more appropriate technology, or the retention of a particular software package which provides lesser all round functionality because a cost has been incurred in developing ad hoc reports, even though they may be standard in the alternative package.

### Impact on IT strategy

IT investment should deliver value and therefore determine your IT strategy and its execution in terms of the future value to be derived. Don't be held hostage to historical circumstances! ♦