Return on Investment (ROI) has become a buzzword over the last decade, but the reality is that many people, especially these days, are averse to making investments in their business. They want to see the returns, for sure, but seem to think (or hope at least) that the return can come even if they don’t make the investment.

I call this thinking Return before Investment (RBI) and it is very damaging. Of course it would be great to get the return first…after all, the thinking goes, the investment costs money and is uncertain. But the sad truth at the end of the process is that if you don't make the investment you may wait forever for the return

Investment always has to come before return...in the dictionary and in life. The RBI fallacy is in the same category as the free lunch and the tooth fairy.....things we would like to believe in that simply don't exist. First you make the investment and you get to the return later. Later is guaranteed; sadly, the return isn't, and therein lies part of the problem.

RBI syndrome comes in many different forms and it is the single largest thing that keeps small businesses small and holds them back from achieving real success. It is worth taking a few moments to think about what some of the component parts are and to examine the thinking that creates what I like to call *investment inertia*.

Cost vs Investment

At the heart of the issue lies a fundamental misunderstanding of the difference between a cost and an investment. The last thing I am suggesting is that businesses take on more expenses, but there is a reorientation that needs to take place in thinking.

Cost and investment are both expenses, but they are very different in nature, and every expense should be analyzed using criteria that evaluates it properly.

A **cost** can be defined as an expense that supports your business structure and revenue patterns but one that cannot be directly connected to business growth. Typically, costs are viewed as part of overhead rather than supporting revenue growth. Costs should be examined, avoided and cut wherever possible.

An **investment**, can be defined as an expense that will make a change to your business so that it will eventually create a return and more than pay for itself. It should be something that will allow you to grow your business, and investment decisions should be carefully analyzed looking at both the investment and the expected return.

The mistake that so many people make is to see everything as a cost and not apply investment criteria to their decisions. Start to look at expenses differently and discipline yourself to separate them in your mind between costs and investments. You will find that this new perspective will lead you to make positive decisions that you would have previously dismissed as simply been about costs….and avoided.

Calculating Return on Investment

Part of the issue is that we see things as costs because we don't have the structure or the discipline to evaluate Return on Investment properly. Some people never even calculate the ROI, and for those who do, some ROIs are easier to calculate than others.

There are two common mistakes I see people making. The first, as discussed above, is looking at the expense as a cost and not an investment; the second is looking at the gross cost without taking into account the return that will offset it. . Decisions are driven from the wrong viewpoint, and as a result opportunities may be lost.

The easiest ROI to calculate is the cost of a new hire and the direct impact that they will have on revenue growth, and the easiest example is hiring a salesperson. You should be able to see the direct impact of a salesperson on revenues, and it should be viewed as an investment, not as a cost.

In this exercise, the first thing you have to do is to examine the sales cycle of the product or service they will be selling and decide what is the appropriate timeframe to evaluate whether they are successful or not. Let's suppose that your sales cycle is two months. In that case, you will need to have activity measurements in place to monitor performance and should expect to see revenues in month three and have new salespeople well on the way towards covering their monthly costs by month six.

You have to be tough and make sure that you are ready to fire them if they don't meet a predetermined level of revenues by month six and drive the investment decisions from there. This may well affect the way you view the investment, and you may hire somebody better than you originally intended. That's where looking at the monthly cost rather than the annual cost becomes important.

A salesperson making a base of $60,000 a year costs $5,000 a month. If they don't succeed, you won't end up paying them $60,000 and the investment is the monthly expense for the number of months until they are covering their costs, not the annual expense, . If you need to pay $75,000 to get the right person, that is only an extra investment of $7,500 less whatever you expect them to sell.

The same general principles apply to most ROI calculations, but it is much more difficult when the return is more indirect. This happens especially when the investment will free up resources that will make the organization more effective, and that is where most of the investment inertia is found.

Common Investment Inertia Scenarios

An investment can be as simple as hiring a salesperson to grow revenues or launching a new product; it can be as complicated as upgrading your organization or putting more money into the business to make it more effective.

There are a number of instances where I see investment inertia and critical investments not

made. Businesses suffer dramatically from these oversights, which are most regularly found in three areas.

People

I often see business owners who are "working below their pay grade" yet who refuse to hire anybody else because they "can't afford to". The most extreme example was a business owner driving the delivery truck because the driver was on vacation and he couldn't "afford" to pay somebody else $12 an hour.

When a company owner hires a resource to free up their time for more productive activities it is an investment rather than a cost. Rather than simply viewing the new resource as a cost, the correct calculation is to look at what the impact will be on improved results elsewhere.

Let's suppose the owner in the example above (once the driving crisis is behind him) could sell to new prospects and let's suppose that his time when selling was worth $350 an hour. He can't spend enough time selling because he is bogged down by other tasks. If he can hire an administrator at $15 an hour to take on some of those other tasks he will gain more time.

The difficulty is that the investment is a very real cost and the return is much more speculative. If the executive doesn't have the discipline to generate his extra time into a $350 value, then he will have captured Greenland - an expensive exercise in futility.

But if the owner can drive a $350 value from the additional time freed up by offloading work to an administrative resource, the ROI is astronomical. Let's suppose that the owner gains an extra hour of time for every two that the new admin works and drives a $350 value. The "investment" will be $30 and the "return" $350….an ROI of over 1000%.

Marketing

The old adage about advertising is that 50% of the money spent is wasted….but nobody knows which 50%. The same is often true of marketing and there are some very half-hearted investments made in that area.

Half-hearted marketing yields poor results, which include everything from lack of attention to detail to skimping on the "costs" because it is expensive. If you knew that for every Dollar you spent on marketing you got five dollars in new business, you'd probably spend a lot more.

As discussed above, it is essential to measure the investment and he return accurately, and be very detailed in the planning. Skimping on the investment is something that will definitely hurt the marketing campaign and may limit the return that you make. Suppose you spend $2500 and fail instead of spending $5000 and succeeding. What is the ROI on the second $2500?

When evaluating the return it is important that you know the lifetime value of a customer to your organization. When I had my computer service business, my average customer life was over five years, so I knew that a $5,000 a year customer was going to be worth over $25,000 over their life cycle.

This made a difference to my investment decisions as I knew that when calculating the return it was a much larger number than just the initial transaction. This can be an important factor in investment decisions and should not be overlooked.

Undercapitalization

Many businesses are undercapitalized and the reasons are too many and varied to be gone into here. A common correctible example of investment inertia that does hold businesses back is being undercapitalized and refusing to go into debt to alleviate the situation when the debt is available - whether by putting more money into the business or borrowing from a bank and giving a personal guarantee.

Of course it all depends on the level of discomfort, but being undercapitalized can be one of the biggest time wasters that the business faces and can really hold it back. Think about the time that you waste having to field payables calls and dodge people looking for money. It gets even worse when you are on hold with suppliers and having to pay COD, and all this both wastes time and puts an unnecessary level of stress on the business owner.

A number of businesspeople have a fear of debt, and they think that they are better off coping with the distress costs that occur from being undercapitalized because they simply don't feel comfortable borrowing the money. This is shortsighted and if you look at the money that you borrow as an investment then you need to calculate what you think the return will be in evaluating whether to proceed.

I had a client with a high level of distress costs. She was having to pay suppliers on a COD basis and could never hold any inventory because she couldn't afford to. I calculated that she personally was wasting at least two hours a day on counter-productive activities, which obviously held the business back dramatically.

The effective cost to her was at least ten hours a week that she could have been using more productively, an opportunity cost I calculated based on the opportunity cost of that time of over $3,000 a week or $156,000 a year. All she needed to rectify the situation was an investment of $40,000, which she could have accessed from her home equity line.

She was adamant that she didn't want to put more money into the business…yet she was analyzing the return all wrong. It isn't an easy thing to do, but sometimes looking at from a different perspective yields dramatically different results.

Making Investment Work for you

The first and most important thing is to make sure that you look at every expense and determine whether it is a cost or an investment. You have to be hard on yourself in this exercise and really make certain that what you identify as returns are clearly flowing from the investment.

Having done the analysis and determined that you are about to make an investment, keep a close eye on the ball and measure the returns that you have said you expect on a regular basis. The worst mistake you can make is to start making more investments and not monitor them

closely.

If you do monitor your investments and terminate them as soon as you see that they aren't paying off, you will get a lot more confident and comfortable in this area. You will to make investment decisions that have a much better chance of paying off, and you will relegate RBI thinking to fairy land where it belongs.

The impact on your business if you do this will be considerable.