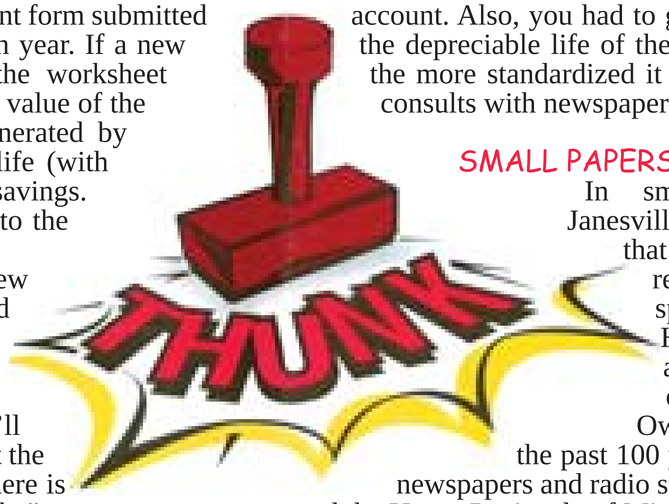
JUSTIFYING CAPITAL PROJECTS

NICE IS OUT, PERFORMANCE METRICS ARE IN AS CHALLENGING BUSINESS CLIMATE AND NEW COMPETITORS CLOUD THE EQUIPMENT APPROVAL PROCESS.

BY PATRICK A. MCGUIRE

Not long after he took over as president of Seattle's Pioneer Newspapers Inc., David R. Lord realized that the way capital projects were approved didn't make sense. "There had always been a perception of 'Gee whiz, we get new equipment because it's nice to get it,'" says Lord, who heads the family-owned publishing business with newspapers in Pacific Northwest cities including Klamath Falls, Ore., Pocatello, Idaho, and Bozeman, Mont.

Nowadays, every expenditure over $5000 must be justified on a special capital investment form submitted to the home office by Nov. 1 of each year. If a new piece of equipment is requested, the worksheet provides space for listing the salvage value of the old item, the increased revenue generated by the new equipment over its useful life (with documentation), and the labor cost savings. The result is a figure that translates to the total return on investment, or ROI.



"Now we way if you want a new stitcher trimmer, do the ROI," Lord says. "And if you say it's going to save your $20,000 a year in labor, that savings better show up in your operating budget. People say they'll save X-amount, but when you look at the operating budget, you say 'Well, where is it?' You have to hold them accountable."

When it comes to justifying capital spending, newspaper executives across the country agree with Lord. Form smaller-market publishers like Bliss Communications' Skip Bliss, who admits "we've gotten a little more regimented than we used to be," to large groups like Gannett Co., of McLean, Va., where Vice President of Production Mark S. Mikolajczyk says, "ROI is the ultimate," "nice" has become just another four-letter word.

"I've not experienced anyone justifying programs on anything other than the bottom line," says consultant Steven L. Derman of The Austin Company of Cleveland. "Everyone today is cost-drive."

ROI REMAINS KING

Capital projects generally come in two flavors. "You can't figure ROI on a leaking roof," says Lord. "With some projects, you don't have a choice." The term often applied to those is "cost avoidance," where there is no true ROI. Instead, the need to stay in business is usually justification enough.

The vast majority of projects, though, are expected to show a return. The requirements for the precise amount of return - and the length of time it takes to trickle in - vary dramatically, depending on an organization's specific needs and culture. "It depends on how a company is driven," says Derman. "Obviously, some have process improvement in mind - cost reduction, quality capabilities. Some are drive by replacement of equipment."

Still, says Vienna, Va., industry consultant Chuck Blevins, a former Gannett production executive, one common denominator exists. "It has to cover its own cost." While at Gannett, he says, it was agreed that the ROI had to be more than a return on the same money drawing interest in a bank account. Also, you had to get your money back in half the depreciable life of the item. "The bigger you are, the more standardized it is," says Blevins, who now consults with newspapers on their capital planning.

SMALL PAPERS, BIG PROJECTS

In smaller markets such as Janesville, Wis., it's not always that ready. "The trouble is all revenue ideas are somewhat speculative," says Sidney H. "Skip" Bliss, president and chief executive officer of Bliss Communications. Owned by the Bliss family for the past 100 years, the company operates newspapers and radio stations in Wisconsin, Illinois and the Upper Peninsula of Michigan.

"In smaller papers, it begins to get fairly difficult to track how much revenue came as a direct results of new equipment," he says. "We try hard to find ways we can use equipment to get cost returns or additional revenue, and to identify what they are."

For the last several years, the capital projects process at Bliss has begun earlier and earlier. In July, the company's corporate systems director sends a packet of information to managers and publishers. In October, approved projects are submitted to the board of directors.

In between, Bliss and a select committee review each application, consisting of data entered in various columns on a spreadsheet. One of the columns has to do with ROI.

"That column, for many years, tended to be sort of skirted," says Bliss. Now "we look a little harder," including face-to-face meetings with managers requesting equipment.

"What we look for is management that makes a commitment," Bliss says. "They are down on paper saying, 'I agree we should produce more,' or, 'Here's what we'll do when we get the equipment.' Once we get them to make the commitment, we trust our people."

In large corporations such as Gannett, the process is similar, even the face-to-face sit-downs with publishers.

"In our company, ROI is generally understood pretty well." says Mikolajczyk. "We have set procedures - forms folks have to fill out to apply for a capital project. We require them to take a hard look at ROI, to justify it, whether it be revenue increases or labor savings. You show where you are achieving the savings."

Publishers rate each of their project requests on a one-to-five scale. "One means you need it to stay in business," says Mikolajczyk. "Five means you wouldn't do it if the money were free."

In terms of revenue returns, the standard rule at Gannett is 15 percent, according to Mikolajczyk. "The only things we look tightly on are projects that have no ROI. Things like second-generation editorial system replacements - or even third-generations."

Such systems, with ever-changing technology, are often written off as the cost of doing business. "The thing is, there's always something you can find in a non-positive ROI," Mikolajczyk. "You always look for potential energy savings or internal building workflow improvement, or internal safety issues that generally don't have true-cash ROI, but contribute to future cost avoidance."

One thing to look for in cost-avoidance projects are ongoing trends, says Gerry Riley, vice president of production at The Journal News in White Plains, N.Y. For example, in deciding whether to spend $200,000 to rebuild a 30-year-old inserter or buy a new one, examine insert volumes over the past several years.

"Let's say they've increased 5 percent a year," says Riley. "You then figure in the extra labor and hours. In terms of cost avoidance, you might think of getting a larger inserter with 30 heads."

With 32 years in the business, Riley firmly believes that the key to any capital project is the preparation that goes into it. "Without the proper prep work, you can't fully understand a project or do a good job of justifying it. Certainly there's more of an awareness of that today than there has ever been."

Before the pagination revolution, he says, the justification for new equipment was usually reduced hours. But today, "we have reduced expenses as far as we can go without adding equipment. So revenue generation is what we focus on throughout."

TOP DOWN , OR BOTTOM UP?

But throughout what? The entire plant, or just the operations department? Sometimes an expensive disconnect crops up between the top and bottom floors.

"Newspapers are now becoming more sophisticated in calculating ROI - to the extent that it's sometimes incomprehensible," says Blevins. "There is often a gap between the need and the accounting department. Take the people in the mailroom who know that the old tying machine is driving them crazy and making life miserable every night. They don't know how to justify a new one."

It's not just the mailroom. "Fewer and fewer production people are traveling now," he says. "They are becoming less and less aware of what's on the market. You have more top-down directed stuff. The middle people aren't going to know what's going on. They might not know the value of an

DO YOUR HOMEWORK

Where do you start to convince your company to buy or repair expensive equipment? Industry officials list two basic musts: Learn your company's rules, and do your homework.

Rules:

- What is the deadline for proposing a capital expenditure?
- Are there forms to fill out?
- Is a return on investment required within a specific time period? (Some companies require a full return within seven years for new equipment, 40 years for new buildings.)
- Is a specific rate of return required? (Some companies expect 15 percent.)
- Is there a depreciation hurdle? (Some companies expect the return on their investment to come back within, say, in half the time it takes for full depreciation on the item.)

Homework:

- Prepare to assess the need in concrete terms. ("It costs us X to do it this way, but Y if we bought or repaired equipment." Or "If we don't do X, we won't be able to compete or stay in business because of Y costs.")
- Would it be cheaper to repair an old piece of equipment than buy a new one? Prepare to back up your answer with data.
- Talk to key people in accounting to learn the kinds of information that makes or breaks a project in your company. Ask to review forms for projects that were funded in the past. What makes them attractive?
- How much has your company spent annually on capital projects in past years? Is it a set amount each year, or is it flexible? (That's important to know because you may be competing for the same pool of money as other proposed projects in the company. Be realistic about what your company can do.)
- Create a realistic time frame for researching costs savings, revenue potential or cost avoidance issues. Give yourself at least three months for projects under $500,000 and up to a year or more for those over $1 million.
- Prepare to document everything. You need to prove your case with hard dollar figures, not soft estimates.
- If your project will show a labor savings, prepare to show an operating budget that reflects those savings.
- Recruit others in the company who understand the process to act as advisers.
- Learn what other newspapers are doing in similar situations.

item. They might not know in Wichita that the project will increase revenue. That's becoming more and more of a problem."

Sometimes the problem surfaces with an amusing wrinkle. Blevins recalls a plant Gannett purchased several years back, where the carpeting was threadbare and full of holes. Photographs were sent to the accounting department, which rejected the new carpeting request. Why? The staff photographer who'd shot the old carpeting had done such a nice job that it looked like a work of art.

"I think there's still educating to be done," says Derman. "Floor-level people are minimally involved in opportunities for assessment of capabilities, features and functions."

"In terms of understanding the cost model, the metrics that they focus on if it's a new press, for example, would be waste, productivity and things of that nature. I'm not sure ROI is really in their forefront."

"The closer you get to the work, the less encumbered they are with knowledge," Blevins adds. "Some companies do an excellent job at keeping their line people involved. That's excellent, because it gets them thinking the same way as the boss."

Ultimately, he says, newspapers need to behave more like other businesses in keeping line workers up-to-date. "The biggest difference between a newspaper and a regular business?" Blevins asks. In a traditional manufacturing plant, he argues, everyone know that he or she can make or break the business.

That doesn't necessarily mean breakage is intentional. Often, say the experts, a lack of corporate foresight can limit what hands-on employees can do to make the business better, particularly as the market continues to change.

"It's short-sighted to replace equipment with things that will duplicate the current equipment and have a life expectancy of 25 to 30 years," says Derman. "If you're not looking far enough out, then by the time the decision is made to buy and the time you get the use of the new equipment, two-and-a-half years might have elapsed. Quite a bit could occur in the market unless somebody has a steady hand."

As an example, digital cameras have become so commonplace and so inexpensive that requests for traditional film-based cameras are now the ones that draw scrutiny, according to Blevins.

Bliss agrees. "There are a variety of reasons you would invest in new technology. One is to be able to produce higher quality. And one is to be more efficient. That means there is some cost return attached. Some new systems eliminate a certain amount of people getting up and going back and forth from the classified office to the accounting office. Those people can spend more time actively selling. That ought to produce revenue."

QUALITY AS JUSTIFICATION

But are efficiency and quality given equal weight in calculating ROI? Is quality something you can quantify at all? That, says Dario D. DiMare, president of Framingham, Mass.-based Dario Designs Inc., is one of the most misunderstood parts of newspaper project justification.

"Hard costs are very easy to quantify," he says. "If one machine replaces two, divide the capital in half. If one machine is faster and you need fewer people, subtract the labor costs."

Soft costs are trickier. These are the items found on many a project justification form, usually as bulleted points without an assigned dollar value.

"Say they want to buy a new press. The bulleted items say we'll be able to get out more sections - but that doesn't get a nickel in ROI. We'll get more color, but they won't pout dollars by it. We'll get a tighter fold with a new job folder, which means a better product and fewer misses and quality service," DiMare says. "All those things never get one dollar when justifying it."

The reason, DiMare says, is that the industry has no method for quantifying time, quality, accuracy, predictability and consistency.

"What are those worth?" he asks. "The accountant says they're nice, but worth nothing. But quality is absolutely worth something."

How much?

DiMare offers the case of a 300,000-circulation daily considering four new presses. When it got down to the bulleted items that justified the expenditure, DiMare saw things like "faster," "an hour earlier delivery," and "news deadlines can be a half-hour later."

"I asked the publisher, 'What's that hour earlier in delivery worth in dollars?' He didn't have an answer. So I said let's take the reverse. Let's keep the deadlines where they are. Why give it to them?"

The publisher, DiMare recalls, finally realized that without the extra hour, he'd need only three presses to accomplish all other goals attached to the project. In the end, the three-press operation was faster than before, generated less waste, and still ended up saving about 20 minutes.

"That hour, given no value at all, was now worth \$15 to \$20 million," says DiMare. "It hits you in the face big time."

"Quality depends on the culture of the paper," says DiMare. "If you get punished for predicting but not coming through, you may see quality issues, but you won't commit. But somewhere between 'scared to buy anything' and 'buying the Taj Mahal' is reality, and you can usually figure it out.

"These are the tiebreakers, the ones when it seems that the project isn't good enough to go forward that you can [use quality] to show that it really should - if you get dollars on the bullet [items]."

The rise of quality as a justification for ROI dates to the founding of USA Today, say many observers.

"Before that, quality was a tough sell," says Blevins. "After it, people found they needed special equipment to match USA Today. Instead of getting a discount proofer, they'd say go buy a good one so you can really match that proof."

The drive for better color reproduction of photographs has been a major push behind quality, as newspapers try to meet the raised expectations of advertisers and readers.

"We live in a color world today," says Derman. "The bar has been raised."

But quality, Derman says, goes beyond the ability to print good color. "It's consistency that newspapers need to get their arms around - predictable results. The market will not tolerate inconsistency."

ROI IN A DEPRESSED ECONOMY

Speaking of the market, industry observers offer differing takes on the recession's effects on capital spending. "In bad times, companies try to conserve cash," says Blevins. "The trust-me value, where I tell you I need it and you believe me, shrinks. Everybody has to justify up and down."

Derman adds he's seen projects deferred and delayed in recent months. However, 'when projects get kicked off the list, it causes people to rethink their timing," he adds. "I don't believe the need has gone away."

For example, Lord says a three-year-old plan calling for a new press at one of the Pioneer papers was deferred for 12 months. "When the economy went south, it made us look at assessments in a different light," he says. That press, however, is still scheduled for purchase this year.

"We haven't slowed down, we haven't sped up," says Riley. "The process is the same. With the economy the way it is, ROI projects become even more important. We're always looking at ways to reduce expenses."

One thing that has changed, Riley says, is the need for papers to become more market savvy. "In years past, a lot of projects were reactive to advertiser needs and circulation needs," he says. "Today, we have to be proactive, to stay on the leading edge and be ready for whatever they throw at us."

Actually, the market has thrown quite a bit at the newspaper industry, most of it coming in the form of increased competitive pressure from nontraditional areas. "Most newspapers don't realize the depth of services they can offer," says DiMare. "I tell them if they don't start performing the way business wants to perform, someone else will do it for them."

To wit, a Canadian commercial printer called Transcontinental now prints The Globe and Mail of Toronto, and other large commercial printers would love to win more newspaper clients, according to DiMare.

More commonly, though, newspapers are taking the opposite approach, buying new presses capable of handling commercial work and niche products.

"Newspapers are identifying needs and opportunities and going after them, says Derman. To successfully compete with the sophisticated commercial sector, he says, newspapers are delving deeper into the financial model of performance metrics, the fancy new term for ROI.

"They are re-equipping themselves and reconfiguring their products," says Derman. "Newspapers are looking at not only products but service capabilities - things like contract printing, or printing regional editions of The New York Times, or distributing other newspapers like The Wall Street Journal. No one is burying [his or her] head in the sand, hoping these issues will go away."

DiMare likes to call the trend toward expanded press use the "go big or go home" concept.

"Either be real good at it, or let someone else good at it do it for you. But my message is this: Don't hire Transcontinental, do what they're doing. They will teach you the hard way if you don't. ■

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