

UNDERSTANDING WHAT 'PRINCIPLES-BASED' MEANS FOR BUSINESS CASE DEVELOPMENT

M.E. Andrews

The Business Case Approach (BCA) used by the NZ Transport Agency is described as a 'principles-based approach' – but what does that actually mean, and why is it important?

BCA Practice Notes are a collection of papers designed to explore specific themes or topics of business case development in depth. They are written with Business Case Approach (BCA) practitioners in mind, but may be of relevance and interest to anyone involved in business cases – whether through development, assessment or decision making. They are not intended as strict guidance in the traditional sense and do not represent formal NZ Transport Agency policy.

All BCA Practice Notes are available for download at: nzta.govt.nz/resources/bca-practice-notes.

For general guidance about the BCA, visit nzta.govt.nz/bca.

Previous approaches to developing investment proposals for funding from national sources have relied heavily on prescriptive **processes** and **procedures**. In this sense, they are primarily **rules-based**. The adoption of a principles-based approach signals a major change in the way transport proposals seeking investment from the National Land Transport Programme (NLTP) need to be developed and communicated.

To understand the implications of this change on the development and the assessment of business cases, it is necessary to start by looking in more detail at what is meant by the terms 'rules-based' and 'principles-based'.

Rules-based approaches

Rules-based approaches can be a very effective way to focus attention on compliance – whether that is statutory, ethical or some combination of both. Historically, rules-based approaches have been commonly used in a wide range of applications, including health and safety, environmental compliance, medical or research ethics and accounting, to name a few.

Rules-based approaches have the advantage of providing a high degree of certainty; by defining rules up-front, it is relatively easy to see what needs to be done in order to achieve compliance. However, they also have several distinct disadvantages. Setting a minimum requirement or standard for compliance may seem an attractive option: 'do these things, and you'll be 'compliant''. The most obvious disadvantage is that people working within the system have no reason to exceed the minimum required standard; rather than setting a minimum, in effect it becomes a maximum level of effort required for any particular activity.

Setting a ceiling on the level of effort might sound superficially attractive, but in practice all it does is limit the amount of creativity and innovation that individuals and groups bring to their work. If the minimum requirement to comply has been set out, why should anyone seek to go beyond that? Critical thinking is not needed where all the requirements are carved in stone; something either complies, or it doesn't.

This 'compliance mentality' removes incentives for innovation and encourages 'same as' solutions, because we know they'll suffice. Increasingly in the transport sector, however, it is apparent that yesterday's solutions won't solve today's problems – let alone the ones we'll face tomorrow. We need an approach that encourages imaginative new ways to address the issues we face.

A further problem with rules-based approaches is that they do not handle complexity particularly well. A rules-based approach works by seeking to provide definitive, prescriptive responses to any given situation that may arise, so that peoples' responses can be consistent and meet the statutory or ethical standards expected.

It doesn't take much imagination to realise that the more complex a sphere of activity becomes, the harder it is to identify every situation that may arise and write rules for them.

Perhaps this is why particularly complex fields of activity such as the ethics surrounding medical research have been using principles-based approaches for some time.

Using a rules-based approach also tends to result in 'one-size-fits-all' situations, where the compliance overburden on small-scale activities can become excessive. An example of this can be found in the US Congress response to the collapse of high-profile financial institutions, including Enron. In 2002, legislation was passed requiring **all** US-listed companies to comply with detailed reporting of their corporate governance and finances (the Sarbanes-Oxley Act 2002).

Many of these requirements are expensive to carry out, placing smaller companies at a competitive disadvantage. This contrasts with approaches in many other countries where similar requirements are included in the rules of listing (on a stock exchange), rather than in statute – an approach that allows more flexibility and latitude to be exercised for smaller companies.

Rules-based approaches also struggle to deal effectively with subjectivity. It is difficult to write rules that will effectively address issues where individuals are likely to have a wide range of views about what is 'right' or 'wrong'. Rules-based approaches are good at helping us distinguish between black and white, but hopeless at helping us to navigate grey areas or work out how to stay within blurred boundaries.

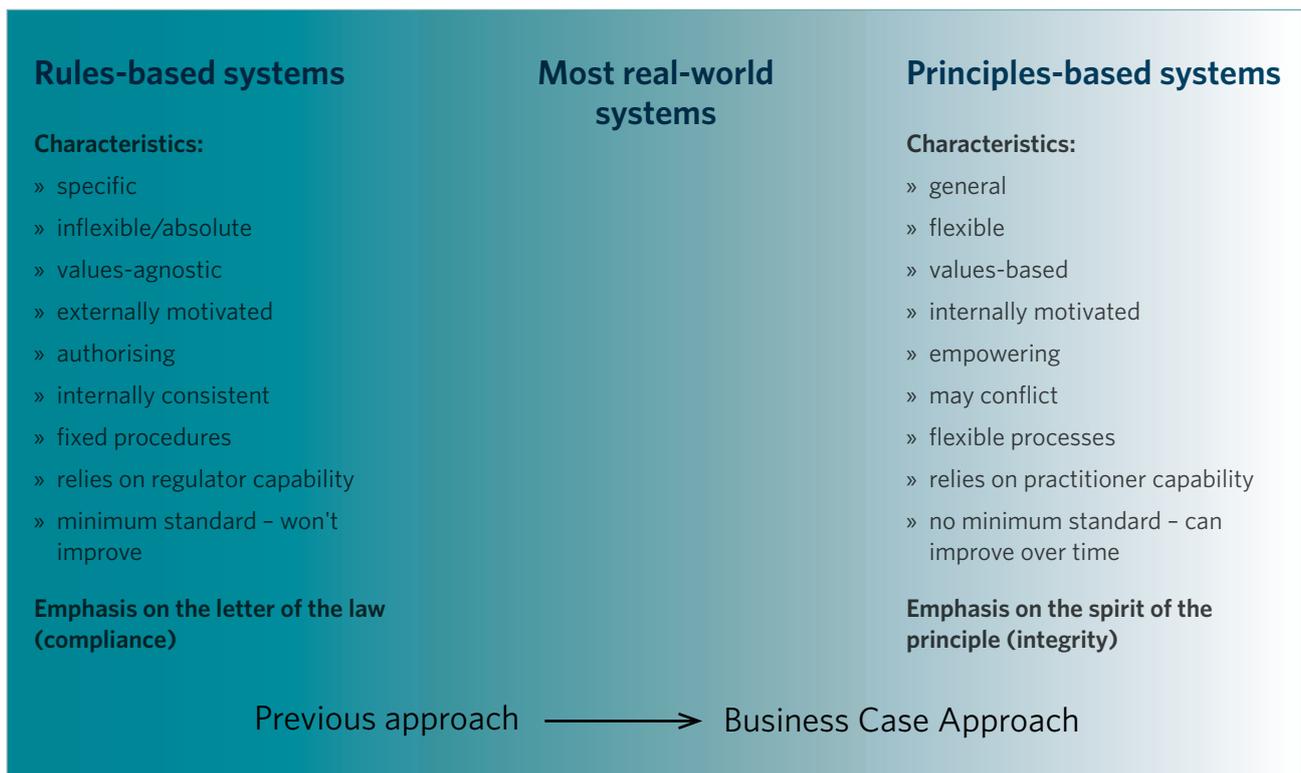
Principles-based approaches

To address these shortcomings, many areas of practice now use approaches that are primarily based on principles. In contrast to rules-based approaches, these do not typically rely on long, pre-determined processes or procedures that must be complied with. Instead, they identify the key underlying **principle** that must be met, and leave how that principle is met largely to the skill and ability of the people applying the system.

In this context, a principle can be defined as 'a fundamental truth or proposition that serves as the foundation for a chain of reasoning'.

The following diagram compares and contrasts principles and rules-based approaches, highlighting some of the major differences and characteristics.

Comparison of rules-based and principles-based approaches



It is clear from the diagram that in reality very few approaches are entirely rules-based or principles-based; most frameworks will include aspects of both. For example, the Transport Agency's BCA, while primarily principles-based, still requires certain things that must be done, for example a cost-benefit appraisal that meets the requirements of the *Economic evaluation manual*.

Examples

The examples below help to illustrate some of the differences between principles- and rules-based approaches among multinational corporations:

Toyota

Despite some previous compliance issues related to delays in product recalls, Toyota has found that its production system's **root cause analysis** framework delivers a sound example of an effective principles-based system. It uses a principles-based approach to compliance, including a strong focus on the role of the individual in the organisation's decision-making process. Toyota introduced a set of nested 'why' questions (the '5 whys') to get to the root cause of quality and production issues. Using this governing principle is a quality norm for Toyota rather than a prescriptive rule to 'ensure x, y, and z parts are working'.

What might appear as nuance is instead a powerful driver of innovative problem-solving. Gone are the check-the-box solutions that, at best, can solve problems the firm already knows exist and which could be used without encouraging employees to look at the root causes behind issues at all stages of the production and managerial process. Individuals are empowered to highlight compliance issues rather than being encouraged to quietly ignore them.

General Motors (GM)

In contrast, a recent compliance crisis surrounding GM's ignition-switch recall failure that led to multiple fatalities highlights the implications of failing to adopt a principles-based regulation culture. It appears GM knew of the defect for more than a decade, since internal documents show that engineers had pointed out the safety concerns in product design reviews.

The root cause of this high-profile compliance failure has been described as a culture of silence at GM: 'See no evil, hear no evil, and speak no evil.' The rules-based system effectively discouraged individuals from acting as advocates for compliance and integrity, and instead ignored and allegedly even silenced the individual in the organisation. The result was that the company failed to tap into the regulatory power of its employees' intrinsic values and moral judgments that could have served as an early warning system for the organisation.

The importance of integrity in principles-based approaches

A significant difference with principles-based approaches is that the emphasis is mainly on the spirit, rather than the letter, of the requirements. This places a higher expectation on all individuals to demonstrate integrity in their approach. What is meant by integrity? Well, in this context it refers to a mind-set that extends **beyond** simple compliance, where individuals exercise their own judgement and moral/ethical values to guide their actions.

As an example relevant to the BCA, it is sometimes clear that problem statements are chosen for their ability to support a pre-determined solution or approach. Often this will be apparent when there is a weak identification of the cause of a problem, or if the consequence is stated in terms of something that will occur if a particular action is not taken or an output is not delivered.

An example of such a statement might be:

Failure to replace the bridge will lead to loss of connectivity.

This statement may appear reasonable if taken at face value; it appears to include both cause and effect, and has a sense of urgency about it – putting 'failure' in any sentence will do that. However, it says nothing about **why** replacement of the bridge is even being considered – has it reached the end of its useful life, is it unsafe, or is the paint simply an unfashionable colour? The existence of such a fundamental yet unanswered question should ring alarm bells for decision makers.

At the same time, stating the cause as a failure to implement the desired solution will instantly limit consideration of other approaches. If an existing bridge is approaching the end of its design life, there are likely to be other, less obvious (but potentially valid) options that could be considered alongside a simple like-for-like replacement. These could include more limited refurbishment or strengthening of the existing structure, carrying out more detailed structural analysis to see if it really is about to fail, or even investigating whether the bridge is still needed. For example, if traffic volumes are very low, would a ford suffice, or are there alternative routes that can be used?

In a recent nationwide assessment of bridge capacity aimed at establishing whether bridges could carry the increased loads from high-productivity motor vehicles, many structures were found through desktop analysis to be at risk. Later field-based assessments found that, in many cases, the bridges were in fact much stronger than thought; this was because the concrete strength, when tested, proved to be much stronger than the necessarily conservative values used in the desktop assessments. Simply accepting the original assumptions would have led to many more structures being replaced than was necessary.

On the other hand, if the reason for considering a bridge replacement is because increasing volumes of traffic have made it unsafe to use, this information needs to be available to everyone working on the business case, as it should be informing the types of response that are considered during development of alternatives and options.

Despite the apparent urgency conveyed in the example problem statement above, such approaches are usually quite obvious to experienced assessors of business cases and do not tend to achieve the outcome the business case owner is seeking. In reality, what they tend to do is cause delays and re-work – usually at a time when everyone is under pressure to make decisions and progress the investment. Unless the organisation's strategic objectives include building as many bridges as possible, there will be little or no contribution to those objectives from this approach.

In contrast, approaching problem definition with integrity, characterised by a genuine desire to understand what is actually happening and communicate it objectively, will help decision-makers quickly understand what is driving the need for investment and whether that aligns well with their strategic goals.

Implications of a principles-based approach for BCA practitioners

The principles-based nature of the BCA represents a significant change from the largely transactional, mostly rules-based nature of previous approaches to land transport investment in New Zealand. While the BCA has been adopted partly to align the sector with requirements for public investments set out by Treasury, there are a number of other outcomes the Transport Agency is seeking, including:

- » providing confidence that collective investment effort is aligned with the desired outcomes in the Government Policy Statement on Land Transport (GPS)
- » avoiding time and money being spent developing proposals that don't align well with organisational goals and objectives
- » enabling and encouraging more innovative approaches to be explored in order to deal with increasingly complex problems the sector is facing
- » ensuring those developing investment proposals connect with decision makers much earlier in the process, allowing investment risk to be more effectively managed.

To achieve these outcomes, it is not sufficient to follow a rules-based approach that actively discourages new thinking and challenging of assumptions. It has become more important than ever to understand and apply the principles that are the foundation stones of business case development – and to use integrity when doing so.

This means that simply ensuring the relevant phases of a business case have been completed will not ensure the business case is successful. It is more important to ensure that at each stage of development the relevant principles have been met.

Similarly, there is now considerable discretion regarding **how** a principle or minimum expectation can be met; while Transport Agency guidance sets out advice or recommends tools to use (for example investment logic mapping or ILM), these are often not mandatory. Practitioners are free to use alternative approaches where they are more fit for purpose.

Key BCA principles and behaviours

To help practitioners, the Transport Agency has identified a number of key principles and behaviours that apply to **any** business case, large or small. The identification of behaviours – as distinct from principles – reflects the importance of culture and behaviour in ensuring integrity is applied throughout the development of business cases.

Principles



Investing for benefits

Investments are made to obtain organisational benefits. An investment should:

- » contribute to the organisation's strategic outcomes
- » represent value for money
- » deliver benefits for customers.



Clarity of intent

The intention driving an investment must be clear. Simple concepts and plain language will provide a clear understanding of the problems and benefits.



Fit-for-purpose effort

The level of effort required to develop a business case must be proportionate to the complexity and risk of the problem and the proposed investment.

Behaviours

These behaviours support the principles:



Gathering information through informed discussions with the appropriate stakeholders

Successful investment management relies on gathering knowledge through informed discussion between the people who have the most knowledge of a subject.



Building the case for investment progressively

The BCA relies on a structured, sequential approach to decision making, checking each phase as you go. All investments must follow the same line of enquiry.

Other principles

The above principles and behaviours represent the essential ingredients that are common to all good business cases; however, they are not the only principles and behaviours inherent in the BCA. More specific principles are indicated in the appropriate places throughout the various phases.

For example, the Transport Agency guidance emphasises the importance of having clear problem statements that capture both the cause and the effect, or consequence, of the problem. Both of these aspects need to be clearly understood (and articulated to decision makers) in order to successfully develop later stages of the business case (see *BCA Practice Notes 2: How problem statements are used in practice*), and hence this is an important principle that guides business case development.

The Transport Agency recommends the use of ILM as a way to meet the expectations of this principle; but if other tools or techniques are more appropriate, they should be used, as long as the problem can still be captured in a simple statement that clearly shows cause and consequence. Alternatives to the ILM approach might be the use of the '5 whys' model for identifying root causes, applied at a team level, say for a relatively simple problem affecting few stakeholders.

Not every principle will be spelled out in black and white, and in many cases there is an implicit requirement that practitioners will familiarise themselves with the BCA to the extent they can recognise the important principles that underlie the guidance. In order to assist this, the 16 investment questions have been developed to guide developers and assessors alike towards the most critical principles. Put more simply, if you can genuinely answer 'yes' to one of the questions – and explain why you are able to answer yes – it is likely that you are meeting an important principle.

Where to find more guidance

- » [BCA guidance on the Transport Agency website: nzta.govt.nz/bca](https://nzta.govt.nz/bca)
- » [BCA online learning modules](#)
- » [Strategic case: defining problems and benefits well information sheet](#).

To provide further guidance on the Transport Agency's expectations for meeting principles, a series of guidance notes have been developed that set out the information that should be provided by the end of each phase of business case development. This not only sets out the expectations around each of the 16 investment questions, but provides an explanation of why it is important to know each answer. The guides are:

- » [What does a good strategic case include?](#)
- » [What does a good programme business case include?](#)
- » [What does a good indicative business case include?](#)
- » [What does a good detailed business case include?](#)