Portfolio Management:

Selecting your projects according to strategic objectives

John Anderson and Robert Buttrick

Why do so many enterprises:

- ***waste scarce funds and resources on worthless projects;***
- ***have little understanding of what benefits will accrue from their project portfolios;***
- ***struggle interminably with the annual budget setting and decision process?***

Research suggests that 35% to 50% of all investment is directed to unsuccessful projects and that about 30% of project investment by FTSE 100 companies actually destroys shareholder value!

Value creation, not value destruction!

The demand for improved returns from investment is now pervasive - and well overdue. Yet most enterprises still struggle with the process of deciding what to do.

Portfolio management is a discipline that offers an escape from these seemingly insoluble problems, providing an opportunity to increase significantly the value derived from project investments. The concepts have been established for 50 years in the financial investment community and are now starting to be applied for planning portfolios of projects. For example, the 1996 Clinger Cohen Act has mandated it for planning the $50 billion of IT investment made by US Federal Government Departments.

What really is Portfolio Management?

Portfolio management is a process that aligns a portfolio of projects to the strategy of the enterprise. As such, it is an integral part of business planning. It enables an organisation to select those projects which will create the greatest value, whilst at the same time:

- ensuring strategic balance;
- handling risk explicitly;
- keeping within resource and funding constraints;
- respecting any dependencies between the selected projects.

In demanding times, this is something all enterprises should be seeking to do, yet it is rarely applied effectively, despite reliable methods now being available.

> ***"The cancellation rate of [IT] projects exceeds the default rate of the worst junk bonds – yet bonds have lots of portfolio management applied to them. [IT] investments are huge and risky. It's time we do this."***
>
> *Douglas Hubbard*
> *Hubbard Decision Research*

What is common practice?

Currently, most enterprises extrapolate from the previous year's expenditure, adjusting for changed circumstances, with some analysis of priorities. The focus is usually upon keeping within a top-down defined budget. Sometimes consideration is given to resource constraints and the level of change the organisation can cope with. Scoring systems are applied together with the judgement of the senior team to aim for a balance of supply, demand, and direction. A view of this is shown in Figure 1 below.

There are many variations on this approach, usually with ever more complex means of scoring.

The process can be frustrating and the results often dubious:

- the project appraisal factors may not align with the overall enterprise objectives
- priorities are often contentious;
- the point at which projects must be rejected may be difficult to determine;
- allowing for resource constraints and project relationships is often seen as too complex.

All one can say, with any certainty, is that it is a bonus that a senior team actually spends time wrestling with this problem, if only for the debate it promotes. Yet there are better ways of doing this. But is it worth the effort to apply these better ways?

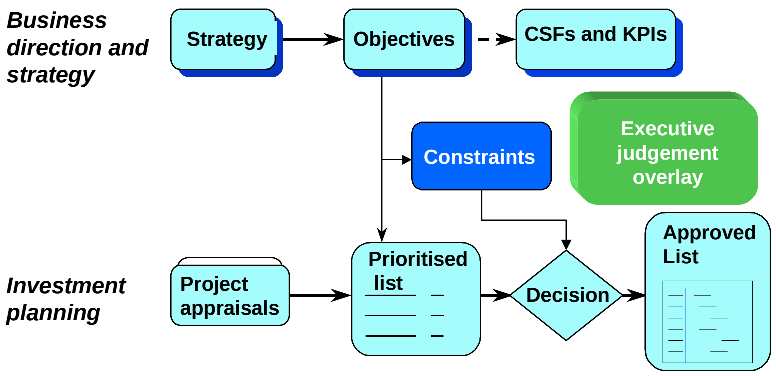

Figure 1 – Current common practice

J Anderson & Associates LLP

PROJECT WORKOUT

Is Portfolio Management worth doing better?

Despite portfolio management being accepted as essential in the financial investment sector, this does not often apply in the wider business community. Why? Reasons often quoted include:

- distrust of excessive reliance on unreliable estimates of both costs and benefits;
- senior executives cannot be convinced to relax their reliance upon raw judgement.

The improvements can be real however:

- in one company the overall return through optimising a project portfolio was a massive 15% increase in the total estimated return;
- research has shown a potential advantage of 19% in average growth and 67% in profit, for those achieving excellence in portfolio management.

It would seem the rewards are there for those enterprises which rise to the challenge.

How will Portfolio Management evolve?

Perhaps what remains is an issue of credibility. How can senior executives become confident that some new practical approaches can be used to turn what they perceive as "theoretical benefits" into bottom line results? Some areas of management practice are now evolving, which if combined, can lead to a far more effective result. These include:

- benefits estimation;
- balanced optimisation;
- decision support.

Estimating benefits can be made more accurate

It is now common for organisations to require an estimate of benefits to justify any project investments. The collapse of the dot-com bubble has accentuated this trend. No longer is it acceptable to simplistically state that the latest technology or general improvements in service quality are reason enough for investment. We must now quantify the business benefit from the technology or the actual level of service quality that will result and if customers will want to pay for it.

Improved market intelligence, combined with benchmarking and multidiscipline team working can support much better estimates of benefits. If the enterprise itself makes the effort to lay out this intelligence, with clear analysis of current performance, the sponsors of projects can prepare better estimates, and save time whilst doing so.

Balanced optimisation will be more effective

The scorecard prioritisation approach outlined earlier in this article is often accepted as the only form of analysis available. Yet this is not the case. Balanced optimisation, using mathematical techniques, can perform the analysis more comprehensively, faster and with a closer representation of the real-world complexities. The concept is shown in Figure 2.

Experience now shows that not only is such analysis possible, it can also be trusted. It does not replace management judgement but rather supports it by enabling the complex factors of benefits, risks, relationships and constraints to be analysed and drawn together. The main point is that such analysis is available and it gives the opportunity for senior executives to apply their judgement from a far better starting point than current methods yield.

Executive decision making can be better supported

The meetings when project authorisation decisions are made can be better managed, to take advantage of improved data and analysis. Strategy setting sessions are often carefully orchestrated, with extensive intelligence provided to assess current performance and evolving business trends. Scenario analyses are usually built in. A similar approach can be taken for portfolio decision-making.

Portfolio management is moving more to a process repeated at regular intervals, rather than an annual budgeting and lobbying round. To support this, those who facilitate the function, can design the sequence in which performance, supply and demand are considered to lead to more rational decisions. Technology can be introduced to allow the evaluation of scenarios and options.

In all, those who must make these critical business decisions can be guided along a path that more naturally fits with their thought processes, concerns and goals.

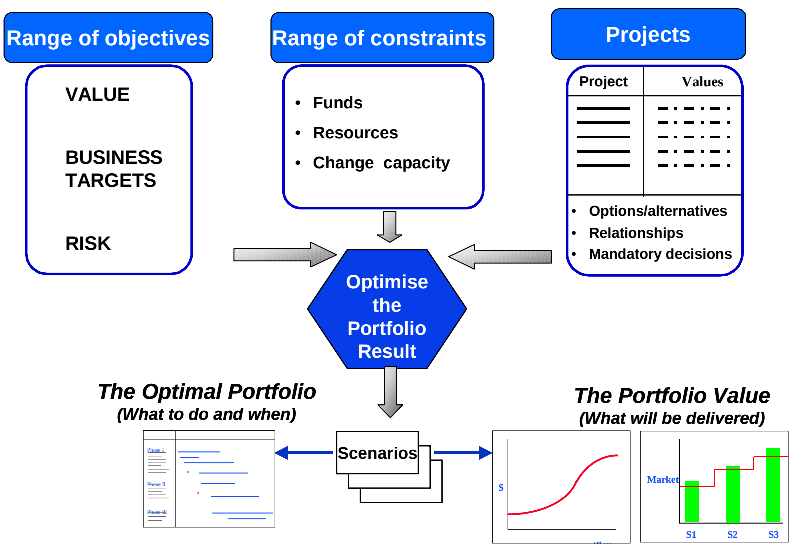

Figure 2 – Balanced optimisation

For more information on business-led project and portfolio management contact:

- John Anderson of John Anderson & Associates LLP: john@woodland.ftech.co.uk
- Robert Buttrick of Project Workout Limited: Robert.Buttrick@projectworkout.com : Web site: projectworkout.com