projecttimes
perspective - education - community

A Top-down Approach to Portfolio Management

Fernando Santiago

During the nineties, we were shocked by the Chaos Report with stats that showed two thirds of projects were failing. After fifteen years and the introduction of new approaches including agile, project delivery has improved. However, there are still fundamental problems that have not yet been addressed.

Despite significant investments in technology and organizational change, companies fail to make the connection between strategy formulation and execution. This is evident as well at the government level where failure to implement strategy has the economy surfing in and out of recession. IT projects are a key component of implementing strategy, and the stats are dismal:

- Kaplan and Norton tell us that nine out of ten companies fail to implement strategy
- According to IBM, 40% of investment in IT is wasted
- Gartner puts this estimate at 20%, equivalent to $600B/year
- If we take IBM's estimate, we are talking over one trillion dollars a year, wasted

If companies are failing to implement strategy and wasting fortunes in IT, there is clearly a problem in portfolio management. The mainstream practice uses a bottom-up approach:

- Put ideas through a "funnel" process, based on a business case that gets progressively elaborated
- Rank opportunities for investment based on their value, risk and alignment with strategy. This sometime involves complex multivariate analytic tools that few people understand or trust
- Select the top of the list for execution, all in a yearly cycle
- Confirm the benefits in the business case after delivery

While this approach is logical and sound, in many occasions leads to unexpected results:

- Business cases based on fiction and not used for decision making
- Executives that bring a last minute list of projects "on a napkin" that jump the queue and get approved
- The verification of benefits becomes an elusive task and just doesn't get done
- Millions are invested and many times there is no clear idea of what the organization is trying to achieve

It isn't surprising that portfolio management has not succeeded in helping companies implement strategy. The term portfolio comes from finance and leads to the root of the problem: the assumption that opportunities for investment are independent, and that each one generates measurable financial returns. Finance departments have dictated the need to come up with "hard numbers" and a rate of return for every project. This approach works well when projects represent incremental improvement of an existing system that is not changing significantly. As an example in manufacturing, a new press will cut scrap by 20%, you put the new press in and measure scrap, end of story.

The problem exists when there is a strategy for transforming the business. As Porter states in his article *What is Strategy*: "While operational effectiveness is about achieving excellence in individual activities, or functions, strategy is about *combining* activities". The key word, in Italics in the original, is combining, as it goes against the concept of independent opportunities for investment. In a transformational strategy, activities are represented by projects that deliver capabilities, which then interact to generate results and sustainable competitive advantage. In his article, Porter presents Southwest Airlines as an example of strategy. In a nutshell, in order to offer lower fares, SW offers no meals, baggage checking or seat assignment and operates short flights from small airports. This allows SW to reduce gate turnaround time and increase plane utilization. In addition, it uses only one model of aircraft to reduce maintenance costs. As a result, SW can offer lower fares than their competitors and point to point flights, and after more than 20 years they are still in the market and thriving. Talking about SW, Porter affirms: "Its competitive advantage comes from the way its activities fit and reinforce one another".

In the case of Southwest, would it make sense to create a business case for "not checking luggage"? How much of the reduction in turnaround time at the gate can be attributed to this? Of course you can come up with a number, but it would be a guess and impossible to verify. Most importantly, in order for the strategy to work, all of the key components need to be in place, so creating business cases and prioritizing a list doesn't work in this scenario.

The alternative I am proposing in this article is a "top-down" business case approach using a Results Chain model that captures the interactions between financial outcomes, business outcomes, capabilities and initiatives. This approach applies to organizations that are planning a transformation, as opposed to incremental improvement. The top-down business case estimates the benefits the organization will realize from transformation; incremental to the results it would obtain using the current business model. The difference between the transformed and the current scenarios generates a stream of benefits for the overall business case for transformation. These benefits are then propagated through the Results Chain based on the relative contribution of each outcome, capability and initiative. Sounds simple? It is; the elegant simplicity of this solution draws a parallel with the alternative provided by agile to the problem of creating a schedule for projects difficult to estimate, by eliminating the schedule and using relative estimates in points. Today most of us accept this drastic approach, which has proven effective in many situations; a simple solution for a complex problem.

Continuing with Porter, Figure 1 is my personal interpretation of the Southwest case study. The overall benefits of implementing the strategy are estimated in $100M, which are propagated from right to left, based on the relative contribution of each element. In the first propagation, 30% of the $100M goes to Revenue Increased, a financial outcome. These $30M are then propagated to Average fare reduced, a business outcome and from there to

Average cost per seat reduced. A second flow starts from the right with $40M propagated to Variable Cost Reduced and from there to Average cost per seat reduced, which adds to the previous $30M for a total of $70M. What this is telling us is that 70% of the benefits are attributable to this business outcome and, as such, should be a focal point for the transformation.

In a similar way, investments for the initiatives are propagated from left to right, and $60M in investments are required to deliver the key business outcome Average cost per seat reduced, which has benefits of $70M, and this should yield a positive return on investment.

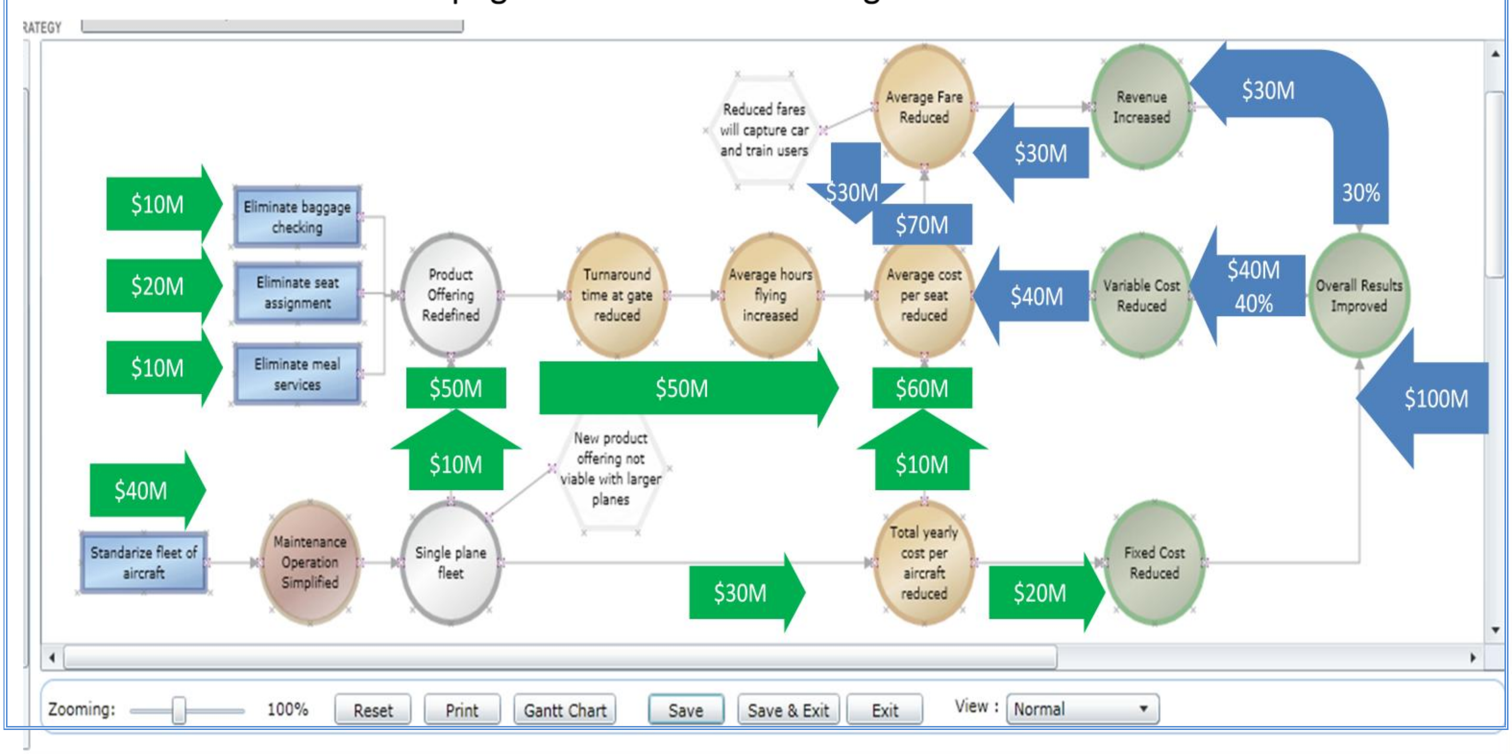
If you find this approach too complicated, there are tools that can handle the propagation and calculation of financial returns and allow you to concentrate on what is really valuable: translating the strategy into measurable outcomes, understanding (and not ignoring) their interrelations, identifying the capabilities to achieve those outcomes and the initiatives that will deliver those capabilities.

The key for this approach is the identification of the proper business outcomes, which in essence "translate" the strategy into actionable and measurable results. All the fluff is removed from the strategy and the organization can focus on achieving those key business results and not just on delivering projects.

Going back to the business case, in this approach it makes sense only at the overall results level, by comparing the incremental benefits from transforming the operation and the investments to get there. The benefits and investments at each node in the Results Chain serve only as a reference to allocate and manage budgets based on the contribution of each element to the overall results.

This may appear as a simplistic solution. However, if we draw another parallel to agile, we find similarities in the fact that, as agile resolved the problem of predicting the future on a schedule based on hard estimates by eliminating the schedule and using relative sizing, this approach removes the need to come up with business cases for every project, and replaces it with relative contributions. Agile

Propagation of Benefits through a Results Chain



works well in projects that have high volatility and where hard estimates are impossible. Similarly, this approach works well in transformational strategy, where interactions make the estimate of benefits for individual projects impossible. In other words, the options are: create business cases based on fiction for those key projects that will transform the company, or look at the transformation with a holistic view, and manage the portfolio from the top.

By taking portfolio management to the next level of translating and executing strategy, this approach provides PMOs with the opportunity to reposition themselves in the organization and move towards a Strategy Management Office, as described by Kaplan and Norton, which focuses on execution of strategy. For consultants, this represents an opportunity to provide their customers with a fresh approach to implement strategy, and if nine out of ten companies are failing at this, and one trillion dollars are wasted every year just in IT, the business opportunities for everyone are significant, and this proposition does have a clear business case.

Fernando Santiago MBA PMP

With over 20 years of experience as a project manager/director and PMO manager in Canada, the USA, Latin America and Europe. Fernando is a solid practitioner, consultant and trainer in the areas of PPM and strategy implementation. Fernando leads P3M Consulting, firm that provides training, consulting and develops PPM software applications.

For more information and resources on this topic, please visit www.p3mconsulting.ca or contact fsantiago@p3mconsulting.ca