The Point and Pitfalls in Portfolio Management

Does your project portfolio reflect your strategy? How to avoid budget dispersion

Corporate budgeting is an obscure process. Usually it involves padding budgets to accommodate for across-the-board cuts, and committees of corporate officers finalizing figures for projects executed far below them. Unhappily, the team making funding choices tends to lack the information needed to accurately analyze what they are actually financing.

The team must answer questions that directly affect corporate strategy. Which projects are critical to corporate goals? Which provide the best "bang for the buck"? How should the projects be prioritized to maximize utilization of resources? What is the risk of each project and how should it be handled?

It is easy for even a corporate budgeting committee to fall into the illusory convenience of arbitrary money and resource allocation, in ignorance of tools to do the job of allocation more efficiently, based on realistic criteria. Providing only part of the money and resources that a project needs, on the grounds that other projects need funding too, will

simply result in incomplete work and little benefit to the organization.

The fundamental challenge of portfolio management is to allocate limited funds and resources (money, talent, space, and so on) in order to achieve maximum benefit for the organization.

Management's job isn't confined to maximizing project output. It has to start with defining the organizational portfolio: choosing and managing the right projects to match the strategy, overcoming resource constraints and project risks, with the ultimate goal of bringing the concept to successful execution.

"Vision" is where the company wants to be in the future. Absence of vision, or vision without priorities, is a waste of money.

Usually vision is created by the senior team, is broken down into initiatives and is then passed down the organizational chain for execution. But the specific vision must not be sanctified: one measure of strategic agility is the

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organization's ability to quickly alter strategic plans based upon changing external factors or alterations in direction. For example, a certain company may place strategic emphasis on cost reduction in one year, then turn to revenue growth or decreased time to market the next year, requiring different project focus.
Portfolio Management techniques help management to make informed evaluations of their strategic plans and progress. Within this criterion, management also needs to address the **stability** and **diversity** of the organizational portfolio, and assure the right combination of projects to support both short-term and long-term needs.
After mapping all the potential projects to support the organization's strategy, comes the tricky part – picking and choosing. Examples for narrowing the options include anticipated return on investment: What would be achieved at the end of this project? Meaning, would the project support market share goals, expected revenues, customer satisfaction, organization effectiveness?
Another narrowing criterion would be the funds and resources needed to execute the project. Funds for inward investment have grown scarcer. In a recent conversation one senior portfolio manager admitted that at her organization, The sum of the investments proposed for the next fiscal year was in the order of three times that which the organization could sensibly afford."
Another organization adopted a "two significant activities at a time" approach: it mobilizes all of the organization's resources and focuses management attention on these key activities. Everything else has to fit around them.
In mature organizations, portfolio analysis is extended to include the implications for funds and resources. This involves forecasting the talent required to perform the project. This can be critical: we have witnessed increasing executive awareness that their ability to execute strategy is not limited by funds, but rather by the availability of critical key resources.
A third criterion is project risk. High-risk projects usually also

The Analytic Hierarchy Process

The Analytic Hierarchy Process or AHP creates ratio-type data throughout the decision process which not only increases the accuracy of the decision but allows for sensitivity analysis after the fact.
Where the AHP differs is that instead of simply ranking the goals of the organization, the goals are prioritized using a pair-wise comparison technique which doesn't just rank one goal as more important than another, but how much more important one is than other. This is how the prioritization ratios are created.
Each of the projects are then evaluated as to how well they fulfil each of the organizational goals, again not simply as a ranking but as to how much more in line they are with the goal versus each of the other projects. These evaluations are plugged into the hierarchy and rated against the goal prioritization to determine which projects best align with the goals.

Because this process has created ratio-type data for both the goal prioritization and the project alignment rankings, sensitivity analysis can now be performed to ensure the model in accurate and comprehensive.

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incorporate higher value, or what we call the "risk premium". But each organization must define the overall risk level it is willing to handle and build its portfolio accordingly. Stable portfolios should usually include a combination of both high- and low-risk projects.

The black art of forecasting

Portfolio Management starts with ranking the projects objectively based on the above criteria.
Once the relative importance of each criterion has been ranked, a matrix-algebra balanced score card technique can be generated to allocate resources in order to maximize benefits. Creating an objective process removes political influences in the portfolio management process and generates buy-in and a higher comfort level in the decision of which projects will be funded.
Different firms employ different decision-support techniques and tools, but which technique to use is absolutely critical to the effectiveness, buy-in, and accuracy of the decision. A good example for such techniques is the Analytic Hierarchy Process, at the end of which the organization can present a prioritized list of projects to execute.
However, using Portfolio Management techniques depends on the ability to obtain consistent measurement information. Assessing the criteria listed above – return on investment, funds and resources, risk - requires data and experience, which are not always available. Estimating required investment for a strategic change initiative has long been recognised as a black art.

Portfolio – "Project Portfolio" – "a collection of projects, programs and other work that are grouped together to facilitate the effective management of that work to meet strategic business objectives" ("The standard for Portfolio Management" by PMI 2006)

Many organizations insist on predicting costs far too early in the project life cycle, but the margin of error may render the number useless. Portfolio Management can be applied only after a reasonable level of certainty can be ascribed to the estimates.
Relying on dubious information will result in dubious output, but aiming at a structured process is better than having no process at all. The process compels management to review the projects by clear criteria, and reduces reliance on "gut feeling". It isn't enough to declare that next year's strategic goal is to conquer new market share unless the goal is translated into feasible projects. Nor can companies handle each project in isolation: they are ignoring the overall portfolio implications and may get carried away by local initiatives that do not fit the larger strategy scheme. Portfolio Management bridges between strategy and execution. Budgeting and portfolio management processes that lack strong, objective methodology create dubiety within an organization as to why one project received funding over another: political influences come to supersede merit. Objectivity will create confidence in the portfolio that otherwise would not exist. The weakness in the technique is not the technique itself but in the data on which portfolio analysis is based, which becomes a question of organizational culture and maturity.
Does the use of Portfolio Management drive maturity in project execution, or is mature project execution necessary before adopting Portfolio Management? We have found that the two must go hand-in-glove.

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