

beyond... the mbh newsletter



Jan 2004

Editors Note

Happy New Year to all mbh newsletter subscribers. We hope you will continue to enjoy the comments and opinions put forward in our monthly newsletters. This month's edition looks at the rise of **portfolio management** as a key source of competitive advantage and economic value to organisations across the globe. Our feature article analyses results of a US survey highlighting the continued lack of investment rigor in determining which business activities or projects to invest in despite the ever increasing pressure on business to deliver *more for less*. The article will discuss the reasons why organisations have failed to adequately adopt and utilise portfolio and investment management processes, and also the need for Project and Change Managers to champion delivery of the resultant increases in business benefit. **mbh** has portfolio management fully integrated into its change management and project management service offerings recognising its vital role in delivering future business growth and of the need for its effective implementation and adoption in order to maximise the benefits it will deliver.

We always like to hear from you so please drop us a line if you have any feedback or questions.

Please enjoy...

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Investment and Portfolio management

For a long time now mbh has been championing the competitive advantage of better financial appraisal methods. Now, a respected survey (conducted by the Kellogg school of management, together with DiamondCluster International, Inc.) in IT portfolio management has been released in the US to further support this assertion. The complete results of the survey can be found at:

http://www.kellogg.northwestern.edu/faculty/jeffery/htm/publication/ITPM_Study.pdf

The objective of the survey and its supporting research was to help organisations make better IT investment decisions. The research provides insights into (and reveals best practices) how to successfully adopt ITPM. As there really is no such thing as an "IT project" (projects encompass all business areas) there is no point having "IT portfolio management". Of course, mbh's philosophy is that portfolio management processes should be adopted across all projects. The methods and tools for achieving this are the same as those currently used for "IT portfolio management", which makes IT the best place to begin developing company-wide portfolio management practices.

While 78% of the CIOs surveyed said they plan to either have or keep "IT portfolio management", only 24% have an optimised portfolio management approach. Other interesting outcomes from the survey were:

- NPV and option pricing were the methods used least in determining investment choice.
- Payback was still a significant factor in decision making.
- Portfolio creation methods are non-standard and vary significantly between organisations.
- 51% of organisations have no process for aligning IT investments to business strategy.
- Only 26% of those surveyed track actual financial metrics against an investment decision.
- 42% of respondents said dealing with the lack of working knowledge among IT staff regarding financial concepts precludes portfolio management.

One quote from the survey sums up the entire reason for mbh's existence:

"The biggest barrier (to managing the IT portfolio) is educating the IT staff on building a business case justification, verses just wanting to please the client" – Laura Scott VP & CIO Carpenter technology.

The rest of this article will take each point highlighted in the Editor's note.

Why are NPV and Option Pricing Not Used?

mbh believes the main reason for not adopting NPV and option pricing is a lack of understanding in business of what these methods are and how they should work.

Accountants with little or no understanding of financial principles produce bogus NPV results using unofficial, but accepted, accounting practices. These practices, when combined with their own lack of knowledge undermines executives' confidence in using these invaluable methods.

Says one respondent, the CIO of a global services firm:

"The problem with doing any kind of ROI analysis is that it's just really hard to do. What I see in my field is that ... come up with these mythical ROIs and it's the wrong analysis."

This type of response is typical of the "no accountability" angle played out by senior management. If "it's just really hard" could be used all the time there would have been no software development; no IT; and no advancement of business practice in any form since the Wealth of Nations days.

NPV and option pricing create the most transparent (hence the most accountable) metrics for sponsors to be assessed against. This increased accountability is the key to improved portfolio management. Convincing senior management to willingly accept and adopt this extra accountability is the biggest hurdle to companies adopting portfolio management practices.

As per previous articles in mbh newsletters, it is our belief that NPV and option pricing are the only true methods to be used when creating optimised portfolios.

Payback is still heavily used in assessing investment decisions;

Until executives are offered rewards/incentives for investing in the long term viability of businesses, payback will continue to exist. This is the most useless measure in existence of an investment's worth, yet it is still used more than any other measure. The requirement for

CEOs to report ever-increasing earnings per share growth (over the two year time frame which represents their tenure in the business) precludes the use of more visionary measures such as NPV and, especially, option pricing.

The methods used for creating portfolios are not standard and vary significantly from organisation to organisation.

Portfolio management of real assets is still an embryonic concept and the companies which get it right and establish optimised portfolio management techniques have the potential to gain significant competitive advantages over rivals who do not have any such processes (or who have sub-standard processes) in portfolio management. This competitive advantage could be enjoyed for quite a considerable period of time as it will be at least 10 years before portfolio management practices mature and become common practice.

Only 26% of those surveyed track actual financial metrics against an investment decision

Again, this is linked to the unwillingness of senior executives to be measured against the decisions that they make. The less transparency there is in investment decision making the less accountability a sponsor has.

42% of respondents said dealing with the lack of working knowledge among IT staff regarding financial concepts precludes portfolio management

This is mbh's key differentiator...we can give your business the competitive advantage by equipping your IT staff with these key financial concepts and methods. Go on, call us today!