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BENEATH THE BUZZ

Beneath the Buzz: Portfolio Management

Portfolio management provides a new way of looking at IT budget control, and along the way helps manage expectations across the organization.

BY DEAN MEYER

Jan 31, 2005 — What's beneath the buzz about portfolio management?

In IT circles, *portfolio management* is being used to describe a wide range of initiatives, from project-approval processes to project management methods and tools.

What's the real meaning of the term, and what should IT leaders be doing about portfolio management?

The Problem
Imagine this: You go to the grocery store and hand its manager $50, saying that's all you can afford for the week. You then explain that you're hosting a dinner party for 12, and you want to serve caviar, steak and chocolate truffles.

What happens in the real world? The manager laughs and walks you over to the hamburger!

But isn't this exactly what many companies expect of their IT departments?

IT is given a fixed budget for the year; then, clients feel free to ask for anything they think they need all year long. They demand virtually infinite products and services for a fixed price. And it's the CIO's fault when the IT department can't deliver.

The Real Meaning of the Term
Unreasonable expectations spring up when the organization gives IT a budget and then expects IT leaders to determine what to spend it on. As hard as they try to make the right decisions, it becomes their fault when they can't please all the clients all the time.

The key to fixing this problem is to view IT as a business within a business, working in a marketplace of diverse clients with unlimited needs but finite spending power. In this context, the IT budget is a "pre-paid account"—a checkbook of money put on deposit with IT for clients to buy products and services throughout the year.

Instead of IT leaders writing the checks, clients should decide what they will and won't buy from IT. The checkbook (the IT budget) is like an investment portfolio, and it's up to clients to decide what investments they'll make—hence the term *portfolio management.*

When clients manage the checkbook, they don't blame IT when they can't have all they want. The IT organization is not the constraint; it would be happy to sell clients anything and everything. The constraint is the size of their checkbook; clients just can't afford all they want. Of course, for this to work, business clients must know what IT services cost, and be assured that IT is charging the right amount for its services.

In this spirit, many IT organizations have established a client steering committee to decide priorities. But there's a lot more to portfolio management than this.

Implementing portfolio management involves the following six steps:

1. **Budget by Deliverables**

   Portfolio management begins with the budget. Instead of deciding IT spending based on prior years, executives allocate funds based on the investment opportunities at hand.

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This requires an IT budget that estimates the cost of each product and service—each deliverable—instead of forecasting the various expense codes for each group as in traditional budget processes.

Costs include both direct costs and a fair share of indirect costs such as overhead. Thus, IT can build in necessary expenses for sustenance activities like professional development and product research, within the limits of competitive pricing.

A budget by deliverables positions clients to defend the funding for the projects and services they need. This is only appropriate, since clients are the ones who suffer when the IT budget is cut—they're constrained to buy less in the year ahead.

2. **Checkbook Management**

   Budgeting fills up "checkbooks." Then, clients "write checks" throughout the year for the products and services they need. This dynamic portfolio-management process keeps IT priorities aligned with ever-changing business strategies.

   To set this up, business units appoint "pursers" to manage their checkbook. Pursers are trained, and clients are informed of the process for gaining approval of their requests.

   There are also some minor accounting changes. The IT budget is held in a "checkbook" account (rather than distributed among IT managers). As work is delivered, an invoicing process moves money into IT managers' revenue accounts to offset their expenses. Rates (with or without actual chargebacks) are extracted directly from the budget to ensure consistency and avoid redundant cost analysis.

   Thus, clients (specifically, their pursers) manage a budget that dwindles to zero by year end. IT managers, on the other hand, are measured by their revenues versus expenses—not the traditional "actual versus planned expenses," which are a function of what clients choose to buy from them.

3. **Contracting and Project Tracking**

   To ensure delivery on every commitment, IT documents all its "contracts" (both service-level agreements and project charters). And systems are implemented to track contracts and progress made on their delivery.

4. **Life-Cycle Cost Estimation**

   Both in the budget process and throughout the year, executives need to understand the ROI of IT investments to make well informed decisions.

   Calculating ROI begins with an understanding of true life-cycle costs, a key element of all IT proposals. This requires methods to identify the elements of life-cycle costs, and tools to improve the quality of estimates.

5. **Benefits Measurement**

   Understanding ROI also requires an estimate of the benefits of proposed investments. IT staff are trained to help clients document expected benefits, including quantification of the so-called "intangible" strategic benefits. In fact, strategic value is not intangible; it just requires different methods to quantify it. (For more on this, see *The Information Edge* by Mary Boone and myself.)

6. **Culture**
   The entire organization, and IT staff in particular, must learn to view the IT department as a business within a business, and recognize that clients have the right to decide what they'll buy from the IT organization.

   Without a culture of customer focus and entrepreneurship, portfolio management may quickly deteriorate into just more bureaucracy. Or these processes may be circumvented by IT staff who are eager to please and make promises to clients without funding from the client purser.

Portfolio management has proven to be a very effective way to manage clients' expectations. In fact, portfolio management does more. It adjusts the IT budget based on investment opportunities. It dynamically aligns IT with business strategies. And it empowers IT staff to set prices that are sustainable. The key to effective portfolio management is this: Design a comprehensive set of resource-management processes based on market economics and the business-within-a-business paradigm.

Dean Meyer helps IT leadership teams design high-performance organizations. Author of six books, numerous monographs, columns and articles, he brings innovative systematic approaches to what others consider the "soft" side of leadership. Contact him at dean@ndma.com *or visit* his website *for information that can help you implement these ideas, or with suggestions for other buzzwords to analyze in future columns.*

Readers Viewpoint
Portfolio Management
Posted: MAR 18, 2005 11:19:33 AM
Good article. It touches upon what I call the "Business Case to BenefitsTM" process. The key aspect of Portfolio Management is to not only determine which projects to approve, but the ability to link the business case justifications with stakholders accountable for the results and a distinct performance tracking process which measures project business value on an ongoing basis. This is the philosophy behind the www.valecurve.com industry leading Speed2Value methodology and tools.

jeff berman
Executive Vice President
ValueCurve Technologies

Continual Investment Analsyis
Posted: FEB 21, 2005 12:41:05 PM
Good article, it articulates the appropriate cycle from the top down. One of the traps that many organizations fall into is evaluating the merits of an investment or a project, launching into it and waiting for it to produce the benefits. Its important to remember that the analysis of any investment must be in a cycle where the investment is continually analyzed against its expected benefits. The markets are dynamic and decisions made six, nine or 18 months ago may not remain valid. Organizations must be ready to curb or stop the investment in initiatives as it goes through its life cylce.

Steve Alexander
Vice President, Consulting
PlanView, Inc.

Portfolio Management
Posted: FEB 16, 2005 01:03:16 AM
This is an excellent way of explaning Portfolio Management. About a year ago META Group presented their version of Portfolio Management and I felt that META had an additional dimension which makes Portfolio Management much more compelling and produces much more business sense. They took a further step of classifying projects into 3 distinct categories: Run-the-business, grow-the-business and transform-the-business. By adding this dimension to Portfolio Management, CIOs are in a better position to demonstrate the value of IT to CxOs and stakeholders. This will allow CIOs to manage the effectiveness of IT assets and projects, whilst reducing the operational costs of running IT annually.

Chee-Yan Sun
Principle Consultant
Hewlett-Packard

Discretionary Vs Non-discretionary
Posted: FEB 15, 2005 10:21:49 PM
Good article with a refreshing viewpoint. There is one other dimension that should be considered. While the above approach is well suited for discretionary investments, it should be reconciled with non-discretionary/ maintenance type expenditure. In other words 'clients' will need to sacrifice a part of their 'chequebooks' on running products and services they bought in earlier years. They can also decide on bringing down their maintenance spend through discretionary initiatives like Applications Rationalisation/ decommissioning, hardware consolidation, etc. Finally the IT organisation should be able to invest in initiatives (such as offshoring) that will bring down their overall costs.

Ashok Nayak
Sr Associate
InfosysTechnologies Ltd.

Portfolio Management
Posted: FEB 11, 2005 10:34:35 AM
Very good approach. I dream this will help organizations change the way the monitor IT performance today (i.e. planned and realized expenses spreadsheet) and also the way organizations demands IT products and services (i.e. I need all this system features done for 'yesterday', and I don't have any money).

Cristiano Kruel
Director
Sincrono - IT Governance

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Dated: January 31, 2005
http://www.cio.com/leadership/buzz/column.html?ID=1926