An Integrated Approach to Business Value Management

Quantifying and Achieving Strategic Goals

February 2011
Topics

• Defining Business Value Realization (BVR)
• Converting Business Goals into Results
• An Integrated Approach to Business Value Management
• Valuation
• Putting It All Together (example)
Defining Business Value Realization

**Business Value Realization (BVR) is the achievement of outcomes that ‘move the needle’**
Converting Business Goals into Results

- Business Value Management - an integrated approach to quantifying and achieving strategic outcomes
- Project Portfolio Management (PPM) connects strategy to execution
- Business Value Realization (BVR) is the outcome of Business Value Management
An Integrated Approach

- **Define Success**
  - Create a ‘Strategy-on-a-Page’ including strategic initiatives

- **Determine What to Measure**
  - Break down high-level goals into measurable targets over time that correlate to the initiatives

- **Create a Roadmap and Performance Dashboard**
  - Break down initiatives into a portfolio of individual projects that have specific goals aligned to desired outcomes
  - Ensure the portfolio aligns to the risk tolerance of executives
  - Be sure you can measure results

- **Manage the portfolio**
  - Be Value Stewards by managing risk/scope/schedule

- **Measure Results**
  - Track project outcomes to validate strategy and improve the process
Setting Up for Success

Strategy-on-a-Page

BVR Graphs

Strategic Initiative Roadmap

Initiative 1

Initiative 2

Initiative 3
Strategic Roadmapping

Goals

• Support the strategy of the organization
• Align departments with the link between strategy and execution by using Roadmaps and BVR graphs
• For each initiative, maximize the value of the portfolio of projects by:
  ▪ Quantifying value
  ▪ Matching the risk tolerance of executives
  ▪ Optimizing resource allocation
• Make the roadmap consumable by defining initiative names stakeholders can identify with
Visualizing Risk and Reward

**Portfolio Mix**
(Bubbles = projects; bubble size = investment)
The Perils of Business Case Valuation

- Types of valuation methods
- Hard / soft benefits
- Common issues
Valuation and Prioritization Methods

• Pair-wise Comparison
• Return on Investment (ROI)
• Break Even Time (BET)
• Net Present Value (NPV)
• Internal Rate of Return (IRR)
• Expected Commercial Value (ECV)
• Real Options
Pair-wise Comparison (Bubble Sort)

- Pair-wise comparison is a ranking technique for a list of projects focused on evaluating 2 projects at a time.
- Based on a few explicit criteria, a project is compared against another and it will either have *more*, *less*, or the *same* value.
- Successive comparisons, each done two-at-a-time will result in a rank-ordered list – note that some levels will contain multiple projects if the projects within that group are indistinguishable.
Return on Investment and Break Even Time

ROI = \frac{\text{Benefits} - \text{Cost}}{\text{Cost}}

BET: Time at which profits pay for the investment
NPV and IRR

- NPV and IIR are discounted cashflow methods

<table>
<thead>
<tr>
<th>Period</th>
<th>Investment</th>
<th>Benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Cash flow (income-expenses) | ($186,480) | $332,640 | $332,640 | $332,640 |
| Discounted cash flow        |            |          |          |          |
| NPV                         |            |          |          |          |

Future benefits are harder to predict than the original investment

NPV tends to result in Yes/No decision-making

\[
NPV = I_0 + \frac{I_1}{1 + r} + \frac{I_2}{(1 + r)^2} + \ldots + \frac{I_n}{(1 + r)^n}
\]
Expected Commercial Value (ECV)

ECV = \[(PV \times P_{CS} - C) \times P_{TS}\] - D

- \(P_{TS}\) = Probability of Technical Success
- \(P_{CS}\) = Probability of Commercial Success
- D = Development Costs
- C = Launch Costs
- PV = Present Value

Source: Robert Cooper
Real Options Theory

- Project investments are treated like stock options
- Decisions are made when to exercise (invest) and how much, based on a business conditions (risk assessment)
- Options theory avoids the yes/no approach of NPV (or other ‘threshold’ measures), and has the benefit of better real-time risk management
Valuation Method Summary

- All methods require the estimation of benefits
- Costs are easier to estimate than benefits
- More advanced methods factor in risk
- The method of choice depends on the organization
- Without guidance, any method can be easily mis-applied
Cone of Uncertainty

Source: Steve McConnell
www.construx.com
Common Pitfalls in Business Case

- Assuming the estimation of benefits and costs is accurate
- The spreadsheet is the truth
- Every group has its own way of determining value
- Over-selling soft benefits
- No compelling reason for change
Compelling Reason for Change

• Benefits must be compelling
  - ‘Twice the speed at half the cost’
  - ‘Revenue increase by 25% within 6 months’
  - ‘Double-digit profitability’

• Non-compelling benefits (as stated)
  - ‘Increased productivity’
  - ‘Easier to use’
  - ‘It reduces our risk’
Questions to Ask Regarding Benefits

• What business problem am I trying to solve?
• How does my solution solve that problem?
• Can I quantify and measure benefits?
• How do I know?
• So what? Do stakeholders care?
## Types of Benefits

<table>
<thead>
<tr>
<th>Hard Benefits</th>
<th>Soft Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>Productivity</td>
</tr>
<tr>
<td>Cost Savings</td>
<td>Ease of use</td>
</tr>
<tr>
<td>Customer Satisfaction Score</td>
<td>Risk reduction</td>
</tr>
<tr>
<td>Process Improvement</td>
<td>Cost Avoidance</td>
</tr>
<tr>
<td>Defect rate reduction</td>
<td></td>
</tr>
<tr>
<td>Rework time reduction</td>
<td></td>
</tr>
</tbody>
</table>

**Common Practice:** Include hard benefits in Business Case calculations, but footnote soft benefits
Putting It All Together - Example

- **Define Success**
  - Create a ‘Strategy-on-a-Page’

- **Determine What to Measure**
  - Break down high-level goals into measurable targets

- **Create a Roadmap and Performance Dashboard**
  - Break down initiatives into projects that have specific goals aligned to desired outcomes
  - Ensure the portfolio aligns to the risk tolerance of executives
  - Be sure you can measure results
### Example Balanced Scorecard: Regional Airline

**Mission:** Dedication to the highest quality of Customer Service delivered with a sense of warmth, friendliness, individual pride, and Company Spirit.

**Vision:** Continue building on our unique position -- the only short haul, low-fare, high-frequency, point-to-point carrier in America.

<table>
<thead>
<tr>
<th>Theme: Operating Efficiency</th>
<th>Objectives</th>
<th>Measures</th>
<th>Targets</th>
<th>Initiatives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial</td>
<td>Profitability</td>
<td>Market Value</td>
<td>25% per year</td>
<td>Optimize routes</td>
</tr>
<tr>
<td></td>
<td>Fewer planes</td>
<td>Seat Revenue</td>
<td>20% per year</td>
<td>Standardize planes</td>
</tr>
<tr>
<td></td>
<td>Increased revenue</td>
<td>Plane Lease Cost</td>
<td>5% per year</td>
<td></td>
</tr>
<tr>
<td>Customer</td>
<td>Flight is on-time</td>
<td>FAA On Time Arrival Rating</td>
<td>First in industry</td>
<td>Quality management</td>
</tr>
<tr>
<td></td>
<td>Lowest prices</td>
<td>Customer Ranking</td>
<td>98% Satisfaction</td>
<td>Customer loyalty program</td>
</tr>
<tr>
<td></td>
<td>More Customers</td>
<td>No. Customers</td>
<td>% change</td>
<td></td>
</tr>
<tr>
<td>Internal</td>
<td>Fast ground turnaround</td>
<td>On Ground Time</td>
<td>&lt;25 Minutes</td>
<td>Cycle time optimization program</td>
</tr>
<tr>
<td></td>
<td>On-Time Departure</td>
<td>On-Time</td>
<td>93%</td>
<td></td>
</tr>
<tr>
<td>Learning</td>
<td>Ground crew alignment</td>
<td>% Ground crew stockholders</td>
<td>yr. 1 70%</td>
<td>Stock ownership plan</td>
</tr>
<tr>
<td></td>
<td>% Ground crew trained</td>
<td>% Ground crew stockholders</td>
<td>yr. 4 90%</td>
<td>Ground crew training</td>
</tr>
</tbody>
</table>

Developed from material by the Balanced Scorecard Collaborative and Harvard Business Review (Kaplan & Norton)

http://www.balancedscorecard.org/Portals/0/PDF/Regional_Airline.pdf
Setting Measurable Targets

1. Ground Crew Training
   - % ground Crew Trained Target
   - % Ground Crew Trained Actual

2. On-ground Time
   - On-ground Time Target
   - On-ground Time Actual

3. Customer Ranking
   - Customer Ranking Target
   - Customer Ranking Actual
Creating a Roadmap to Deliver Value

Ensure each project develops clear goals that drive desired outcomes

Ground Crew Training
Stock Ownership Plan
Cycle Time Optimization
Quality Management
Customer Loyalty
Standardize Planes
Optimize Routes

Ensure each project develops clear goals that drive desired outcomes
Assessing Risk

Portfolio Mix
(Bubbles = projects; bubble size = investment)

Ground Crew Training
Standardize Planes
Optimize Routes
Measure Results

Financial

- Plane Lease Cost
- Market Value
- Seat Revenue

Customer

- On-time Arrival
- Customer Ranking
- No. Customers

Internal

- On-time Departure
- On-ground Time

Learning

- Ground Crew Stock Ownership
- Ground Crew Training
Summary

• **Business Value Management is an integrated approach:**
  - Align strategic goals to quantifiable outcomes
  - Use business value targets to drive roadmaps
  - Measure outcomes to validate strategy and process

• **Strategic roadmapping should include:**
  - Defining measurable initiative and project outcomes traceable to business value goals
  - Quantifying risk / reward / investment

• **Define compelling benefits**
  - Significant Business Value Realization is the outcome of achieving compelling benefits
BVR In Action

2002 Annual Report
- We completed a multi-year project to integrate our acquisitions.
- We proved the validity and viability of our business model.
- We grew revenue despite a poor economy.
- We improved our operating margin each quarter.
- We generated significant free cash flow.

2003 Annual Report
Our revenue exceeded half a billion dollars.
Our operating margin reached nearly 20%.
Our cash flow from operations surpassed $158 million.
- We created Imagery for Creative Customers.
- We expanded our Editorial leadership.
- We led Film into the Digital Age.
- We focused on our Distribution Strategy.

2004 Annual Report
We did what we committed to do by delivering as promised against our key initiatives:
- We improved operating margin > 25 percent
- We grew the editorial business by nearly 40 percent
- We launched the first fully localized e-commerce site in Japan
- We committed to building new revenue streams
BVR Actuals

Financial Charts

Revenue (in thousands)

<table>
<thead>
<tr>
<th>Year</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>$752,720</td>
</tr>
<tr>
<td>04</td>
<td>$622,427</td>
</tr>
<tr>
<td>03</td>
<td>$528,196</td>
</tr>
<tr>
<td>02</td>
<td>$443,011</td>
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</table>

Operating Margin

<table>
<thead>
<tr>
<th>Year</th>
<th>Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>30.1%</td>
</tr>
<tr>
<td>04</td>
<td>27.0%</td>
</tr>
<tr>
<td>03</td>
<td>10.7%</td>
</tr>
<tr>
<td>02</td>
<td>10.1%</td>
</tr>
</tbody>
</table>

Diluted Earnings per Share

<table>
<thead>
<tr>
<th>Year</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>$3.28</td>
</tr>
<tr>
<td>04</td>
<td>$1.72</td>
</tr>
<tr>
<td>03</td>
<td>$1.11</td>
</tr>
<tr>
<td>02</td>
<td>$0.39</td>
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</table>

Cash Flow from Operations (in thousands)

<table>
<thead>
<tr>
<th>Year</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>$255,277</td>
</tr>
<tr>
<td>04</td>
<td>$262,361</td>
</tr>
<tr>
<td>03</td>
<td>$156,054</td>
</tr>
<tr>
<td>02</td>
<td>$105,408</td>
</tr>
</tbody>
</table>
Contact Information

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About Point B

Point B is the first professional services firm focused on project leadership and now, strategic execution. Founded in 1995, the firm provides a diverse and experienced team of locally-based project leaders to companies in Seattle, Denver, Portland, Phoenix, San Francisco, Los Angeles and Chicago. Organizations ranging in size from startups to Fortune 100 corporations turn to Point B for its ability to step into any segment or role of a mission-critical project and help lead it to success. And, unlike many professional services firms, Point B works exclusively for its clients and does not enter into alliances, reseller agreements, or other relationships that might compromise the firm's objectivity. Point B has attracted top project leaders from various industries by offering a culture that promotes flexible work schedules and well-rounded lifestyles for its more than 400 professionals. Additional information on the firm and its offerings can be viewed online at http://www.pointb.com.
Appendix
NPV and IRR

- NPV and IRR are discounted cashflow methods using an initial investment.

\[
NPV = I_0 + \frac{I_1}{1 + r} + \frac{I_2}{(1 + r)^2} + \cdots + \frac{I_n}{(1 + r)^n}
\]

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</tr>
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<td>3</td>
<td>$332,640</td>
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- The discount rate \( (r) \) in the equation is based on the risk of the investment; a higher rate indicates higher risk. The minimum value of \( r \) is called the weighted-average-cost-of-capital (WACC), the rate associated with the interest rate of corporate debt.

- IRR is just a different variation of the equation. Investment and cashflows are held constant and \( r \) is increased until the NPV becomes 0 in the final period.