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'

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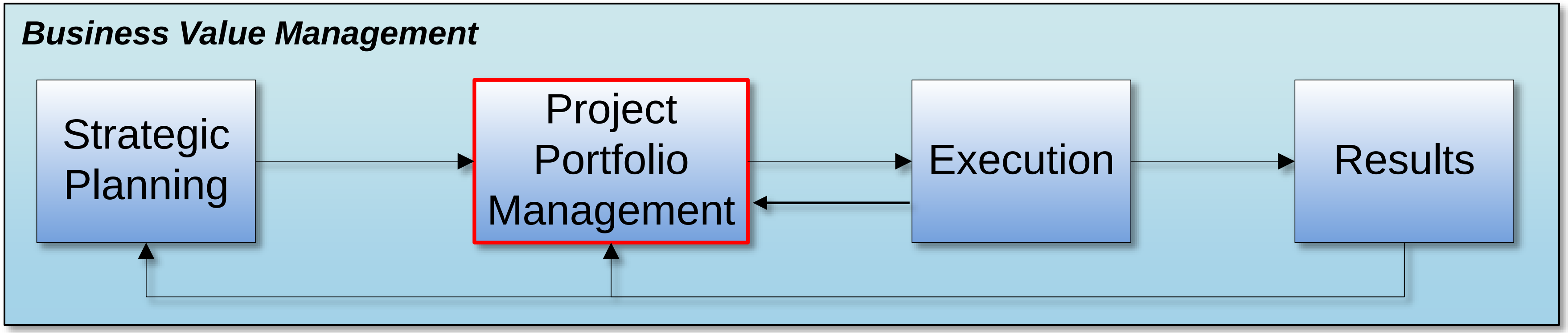
Converting Business Goals into Results



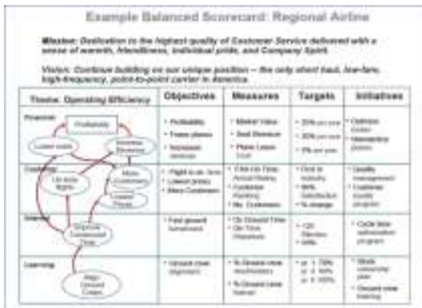
- Business Value Management - an integrated approach to quantifying and achieving strategic outcomes
- Project Portfolio Management (PPM) connects strategy to execution
- Business Value Realization (BVR) is the outcome of Business Value Management

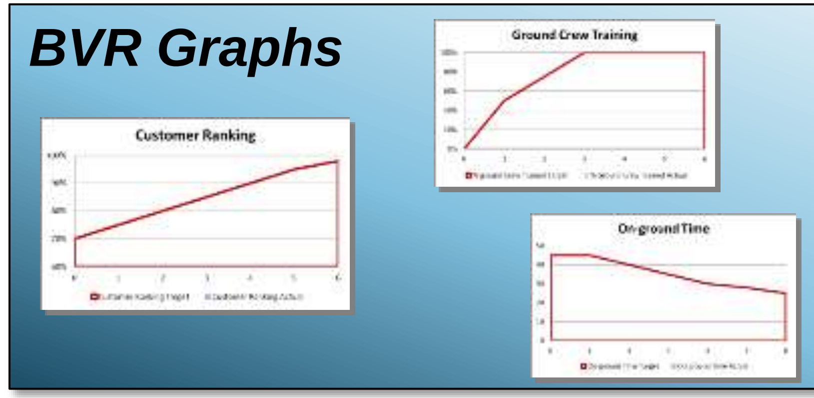
An Integrated Approach

- ***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

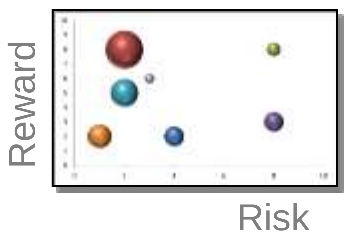
Strategy-on-a-Page



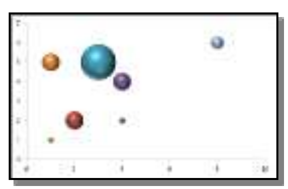


Strategic Initiative Roadmap

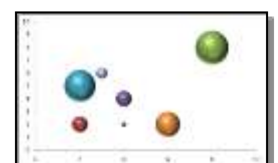
Initiative 1



Initiative 2



Initiative 3



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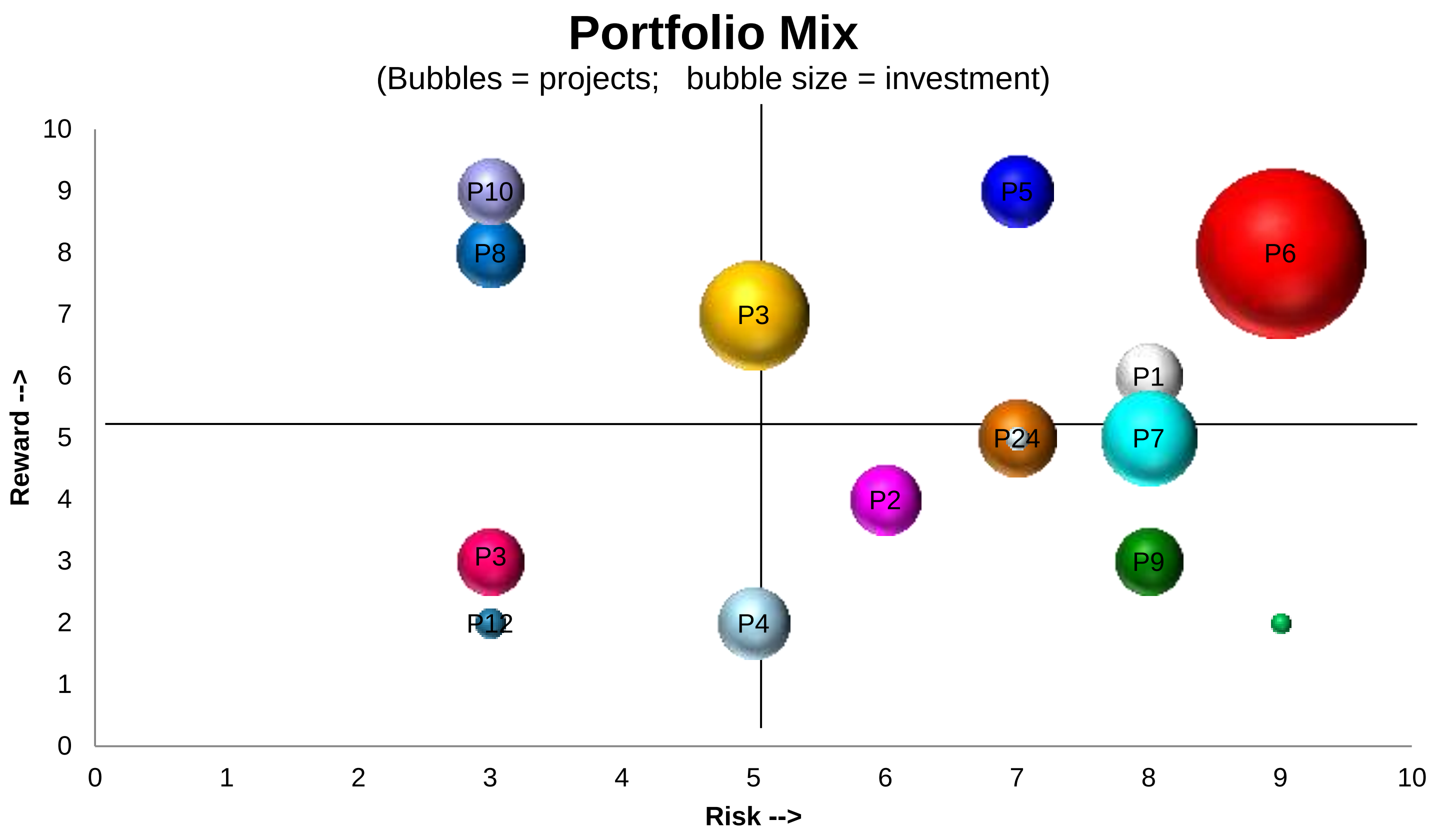
Strategic Roadmapping

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



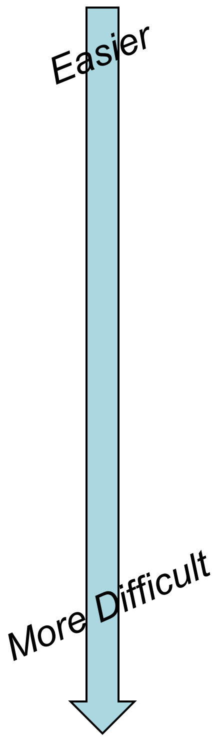
The Perils of Business Case Valuation

- Types of valuation methods
- Hard / soft benefits
- Common issues

Valuation and Prioritization Methods

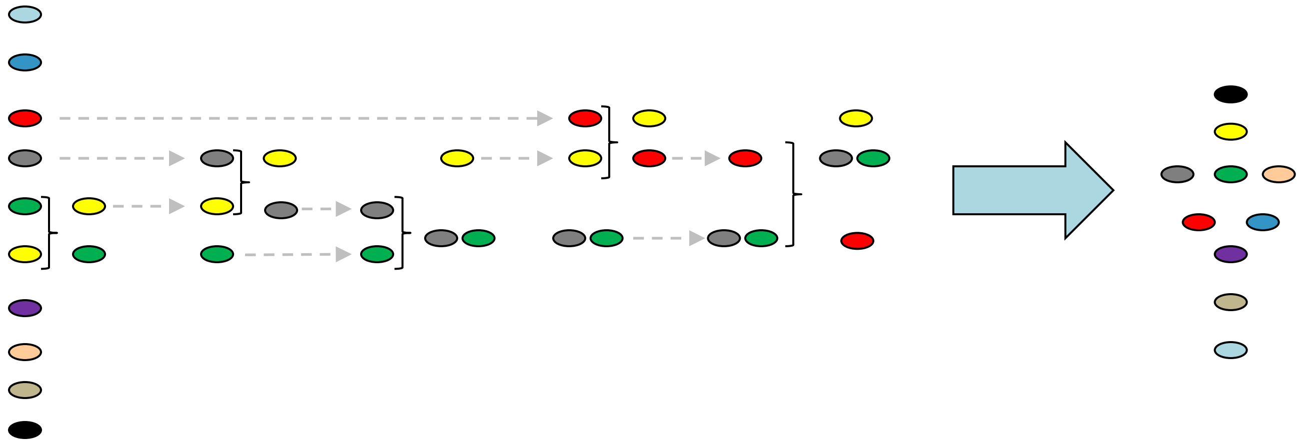
Ease of Use

- 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)

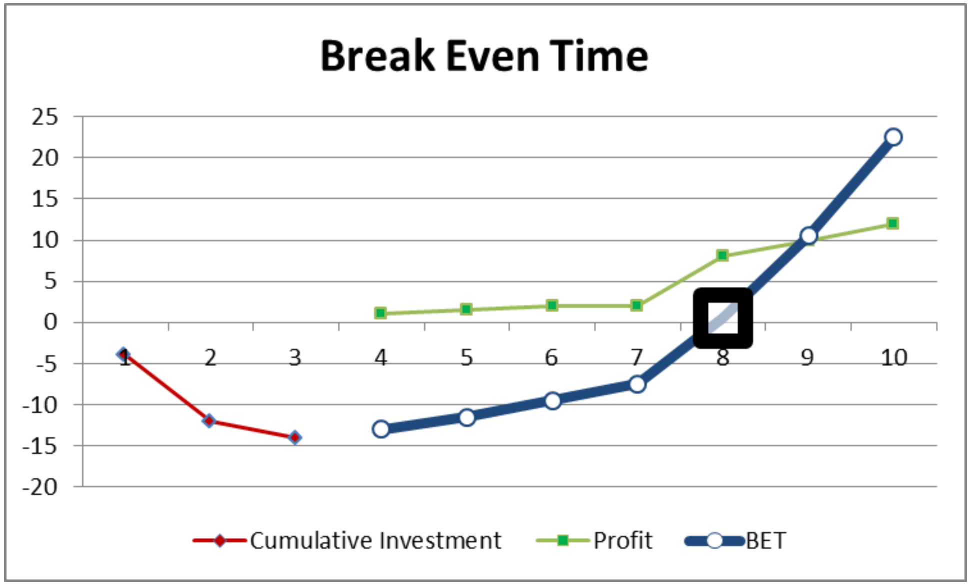
- Pair-wise comparison is a ranking technique for a list of projects focused on evaluating 2 projects at a time
- Based on a few explicit criteria, a project is compared against another and it will either have *more*, *less*, or the *same* value.
- Successive comparisons, each done two-at-a-time will 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

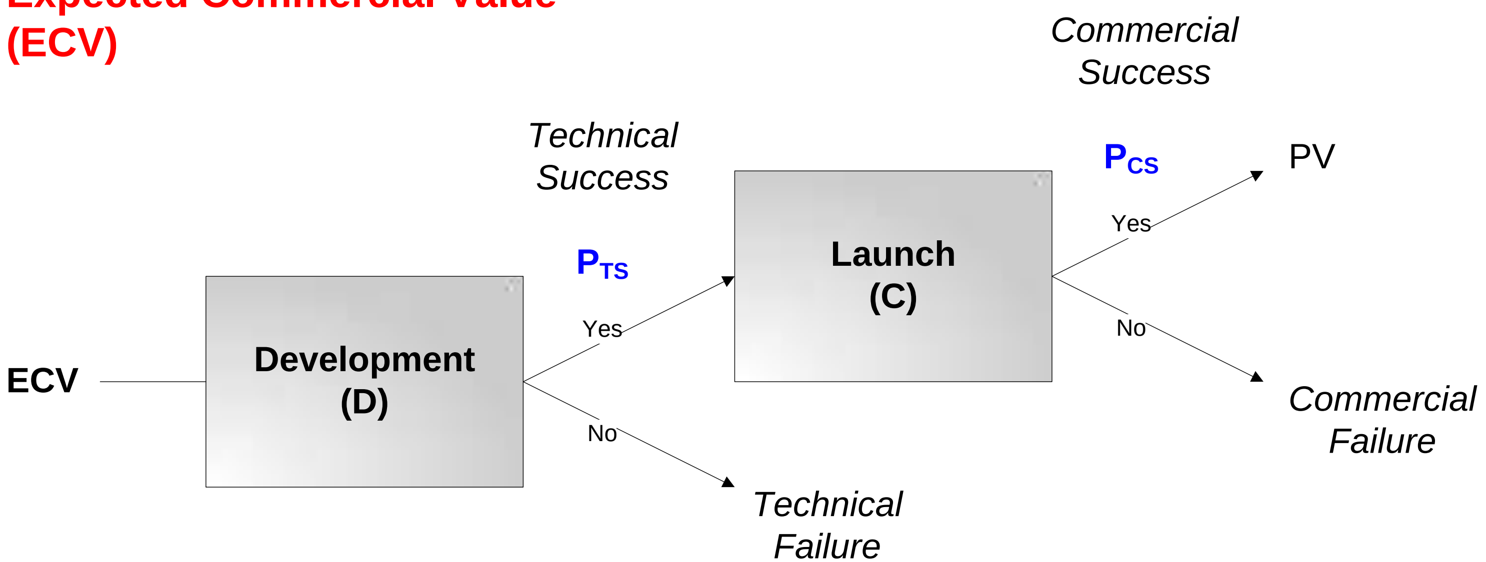
		Period			
		Investment	*Benefit*		
		0	1	2	3
Cash flow (income-expenses)		($186,480)	$332,640	$332,640	$332,640
Discount Rate	15%		0.87	0.76	0.66
Discounted cash flow			$289,252	$251,524	$218,716
NPV			$102,772	$354,296	**$573,012**

$$NPV = I_0 + \frac{I_1}{1+r} + \frac{I_2}{(1+r)^2} + \ldots + \frac{I_n}{(1+r)^n}$$

- Future benefits are harder to predict than the original investment
- NPV tends to result in Yes/No decision-making

Expected Commercial Value

Expected Commercial Value (ECV)



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

P_{TS} = Probability of Technical Success
P_{CS} – Probability of Commercial Success
D = Development Costs
C = Launch Costs
PV = Present Value

Source: Robert Cooper

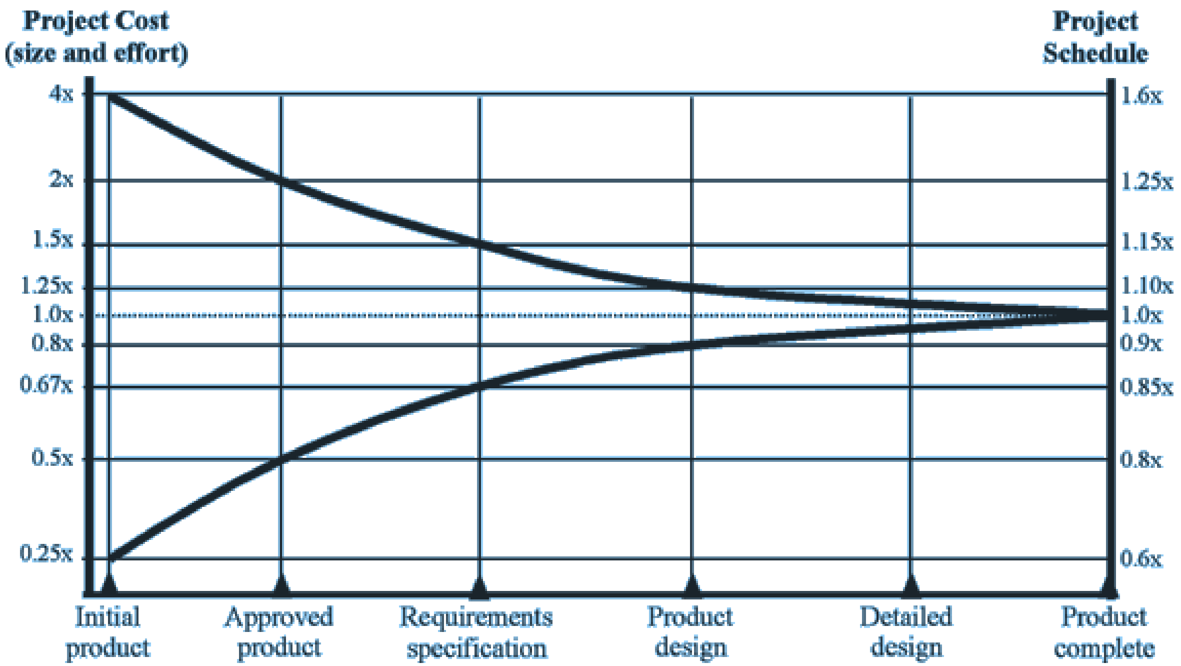
Real Options Theory

- 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?

Business Problem → Compelling Benefits → Outcome

Types of Benefits

Hard Benefits	Soft Benefits
Revenue	Productivity
Cost Savings	Ease of use
Customer Satisfaction Score	Risk reduction
Process Improvement	Cost Avoidance
Defect rate reduction	
Rework time reduction	

Common Practice: Include hard benefits in Business Case calculations, but footnote soft benefits

Putting It All Together - Example

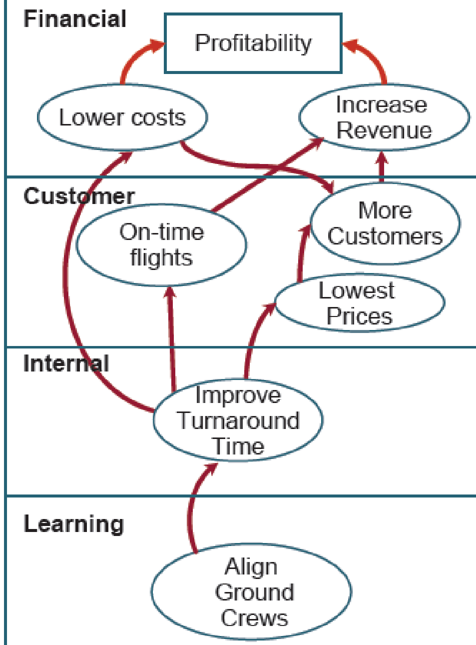
- ***Define Success***
  - *Create a 'Strategy-on-a-Page'*
- ***Determine What to Measure***
  - *Break down high-level goals into measurable targets*
- ***Create a Roadmap and Performance Dashboard***
  - *Break down initiatives into projects that have specific goals aligned to desired outcomes*
  - *Ensure the portfolio aligns to the risk tolerance of executives*
  - *Be sure you can measure results*

Strategy-on-a-Page

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.

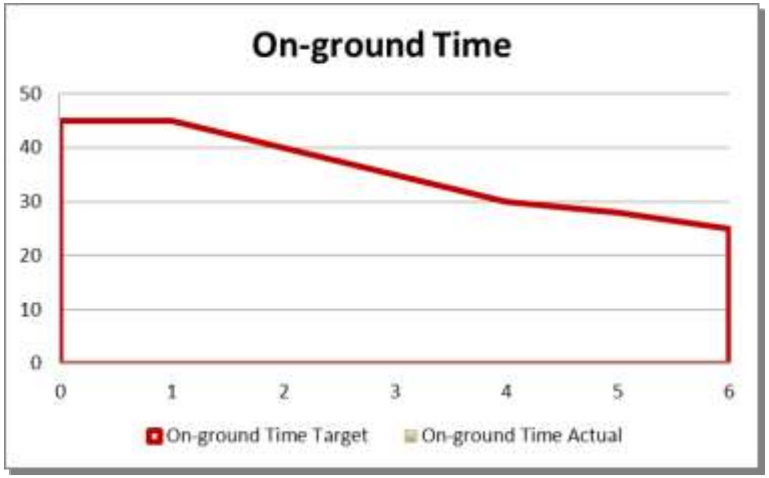


Theme: Operating Efficiency	Objectives	Measures	Targets	Initiatives
Financial	• Profitability • Fewer planes • Increased revenue	• Market Value • Seat Revenue • Plane Lease Cost	• 25% per year • 20% per year • 5% per year	• Optimize routes • Standardize planes
Customer	• Flight is on -time • Lowest prices • More Customers	• FAA On Time Arrival Rating • Customer Ranking • No. Customers	• First in industry • 98% Satisfaction • % change	• Quality management • Customer loyalty program
Internal	• Fast ground turnaround	• On Ground Time • On-Time Departure	• <25 Minutes • 93%	• Cycle time optimization program
Learning	• Ground crew alignment	• % Ground crew stockholders • % Ground crew trained	• yr. 1 70% yr. 4 90% yr. 6 100%	• Stock ownership plan • Ground crew training

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



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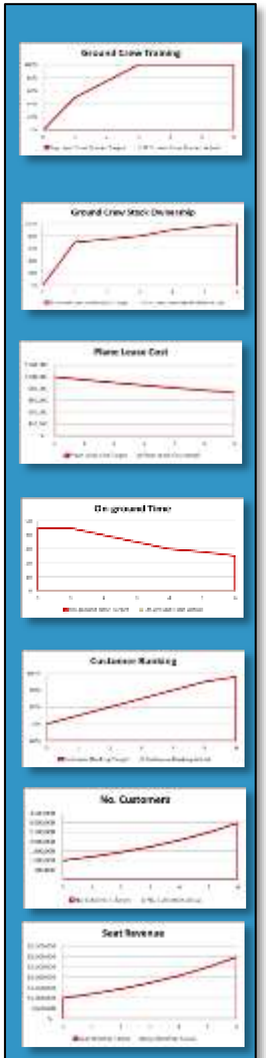
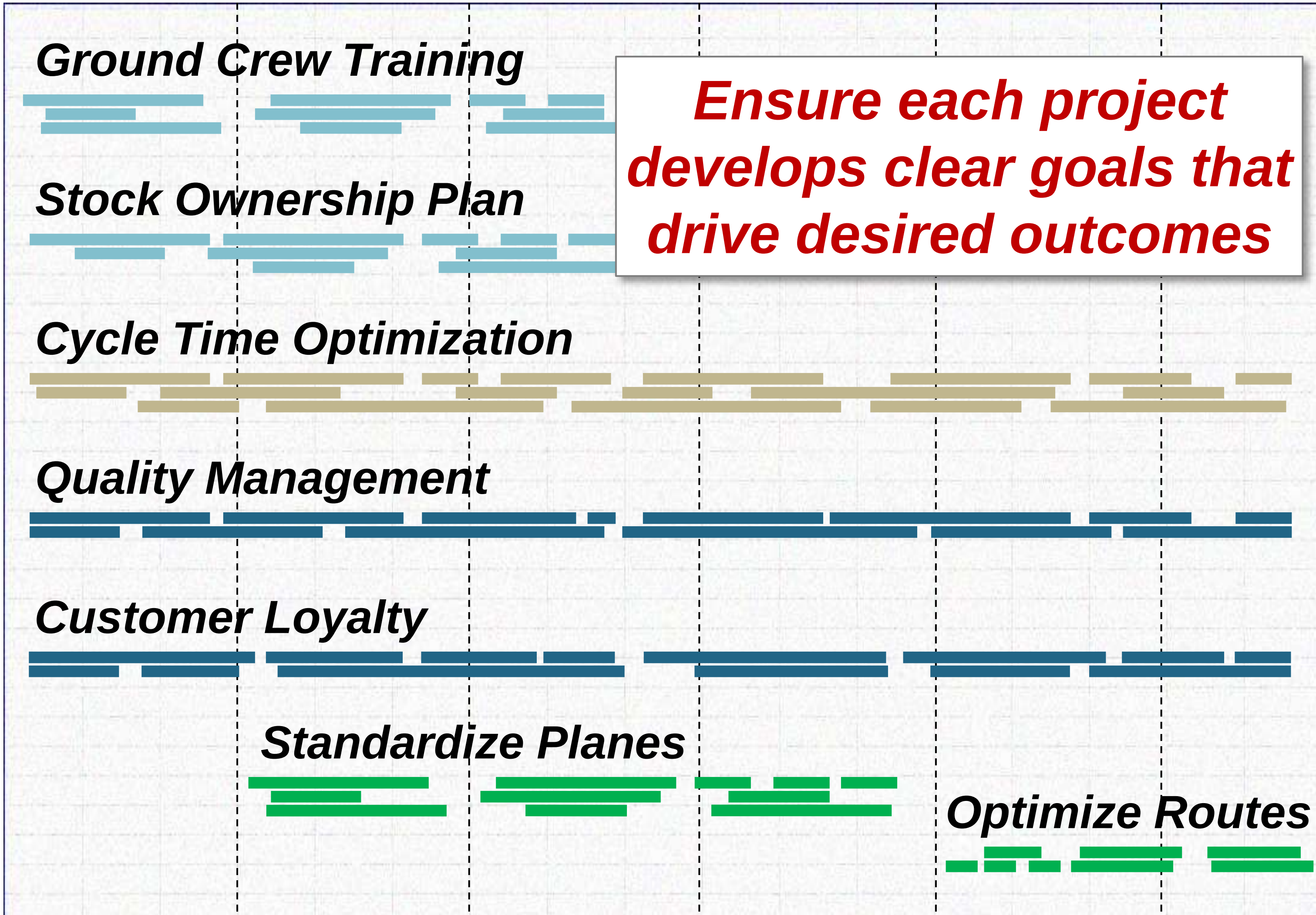
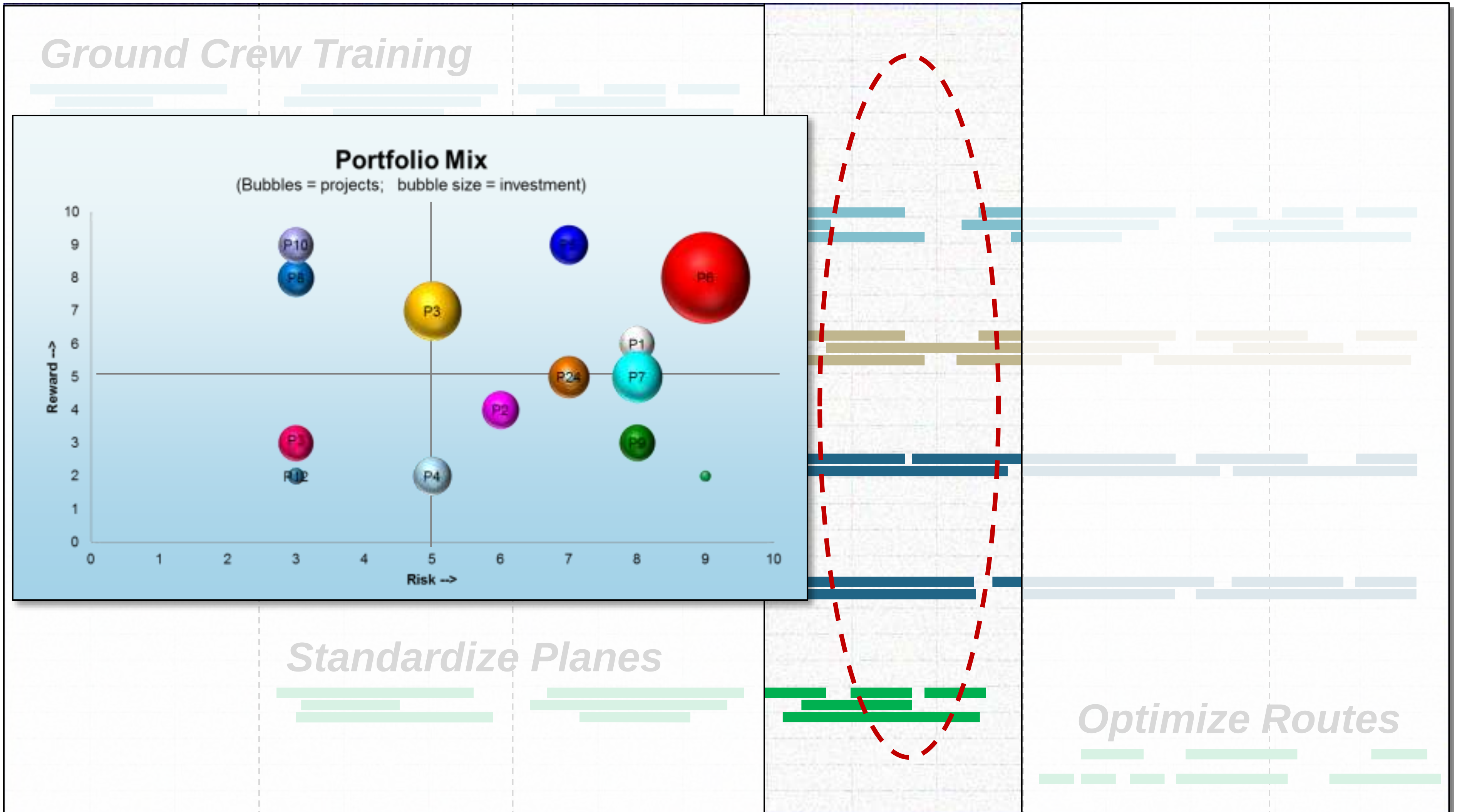
Creating a Roadmap to Deliver Value

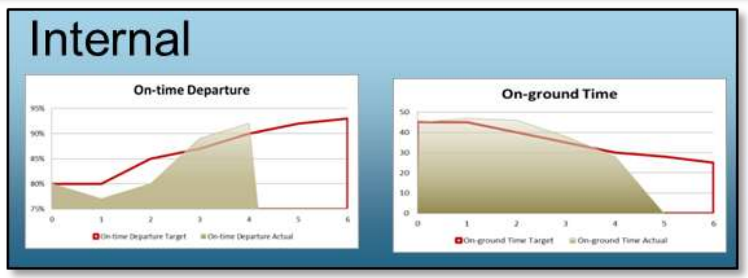


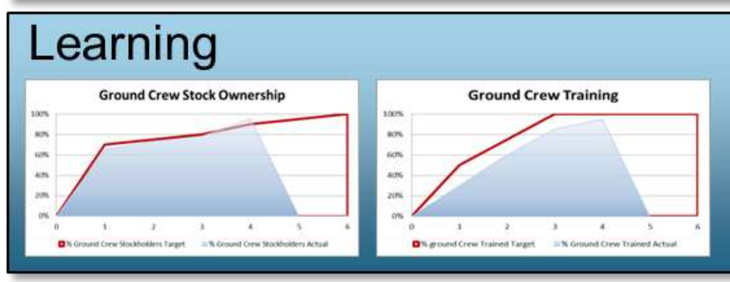


Assessing Risk



Measure Results





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

Integrate Acquisitions

Validate Business Model

E-commerce Innovation

Brand Integration

Generate Free Cashflow

Improve Operating Margin

Photographer Contracts

Expand Content

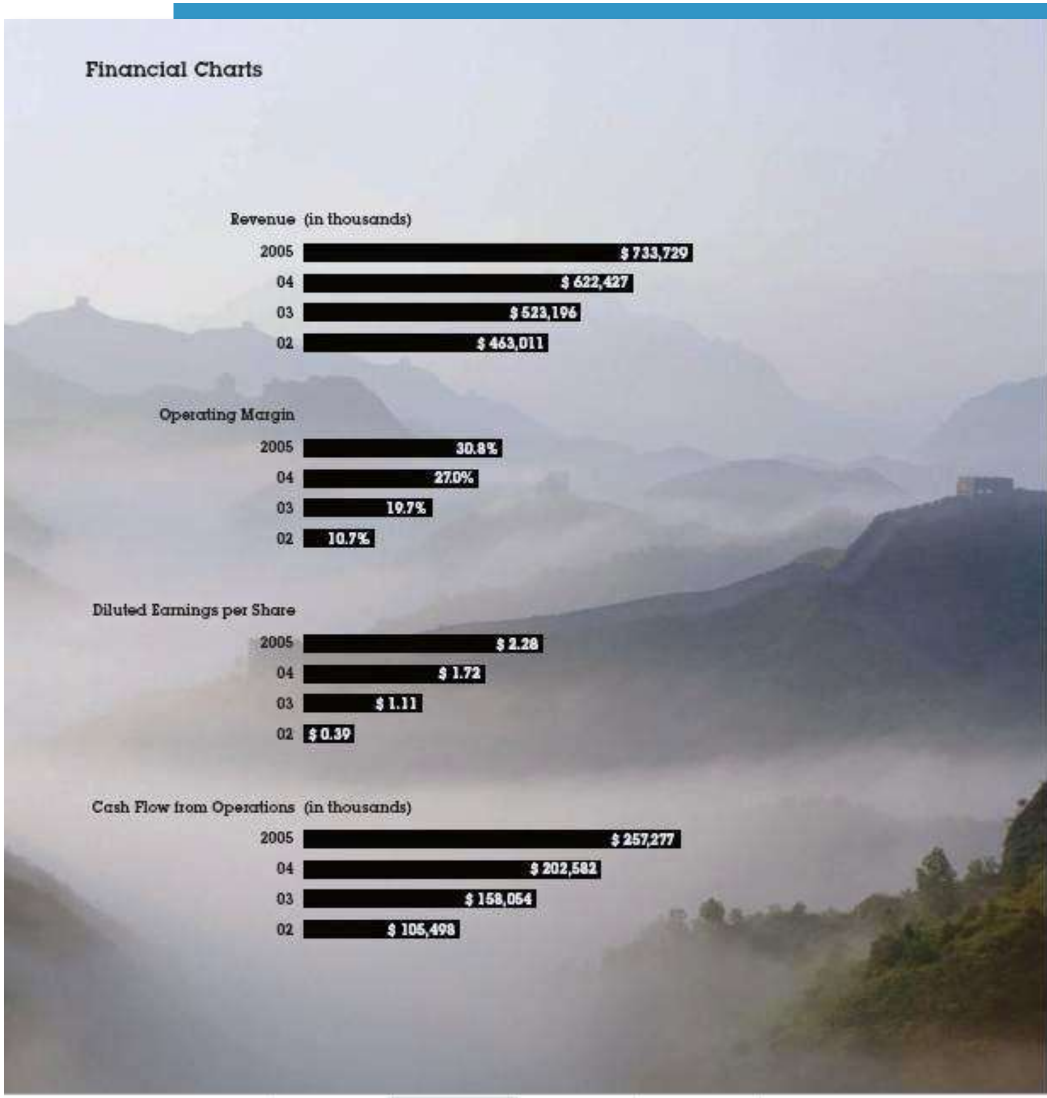
Expand Editorial

Film: Analog-to-Digital

International Expansion

New Revenue Streams

BVR Actuals



Financial Charts
Revenue (in thousands)
2005 $ 733,729
04 $ 622,427
03 $ 523,196
02 $ 463,011
Operating Margin
2005 30.8%
04 27.0%
03 19.7%
02 10.7%
Diluted Earnings per Share
2005 $ 2.28
04 $ 1.72
03 $ 1.11
02 $ 0.39
Cash Flow from Operations (in thousands)
2005 $ 257,277
04 $ 202,582
03 $ 158,054
02 $ 105,498

Dec 1st, 2005 Open: 91.29 High: 94 Low: 91.29 Close: 93.30
2003 Apr Jul Oct 2004 Apr Jul Oct 2005 Apr Jul Oct 2006
Volume
Vol: 375,000
Splits Dividends
1d 5d 1m 3m 6m YTD 1y 2y 5y Max
Time Range

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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

$$NPV = I_0 + \frac{I_1}{1+r} + \frac{I_2}{(1+r)^2} + \ldots + \frac{I_n}{(1+r)^n}$$

- NPV and IIR are discounted cashflow methods using an initial investment

		Period			
		Investment	*Benefit*		
		0	1	2	3
Cash flow (income-expenses)		($186,480)	$332,640	$332,640	$332,640
Discount Rate	15%		0.87	0.76	0.66
Discounted cash flow			$289,252	$251,524	$218,716
NPV			$102,772	$354,296	**$573,012**
IRR - rate at which NPV = 0 in yr 3	**169%**				
IRRDiscount			0.37	0.14	0.05
IRR Discounted cash flow			$123,548	$45,888	$17,044
NPV for IRR calc.			($62,932)	($17,044)	($0)

- 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.