

Inflection Point

Whether viewed as a cost-cutting target or a springboard for strategic risk initiatives, compliance activities are in flux.

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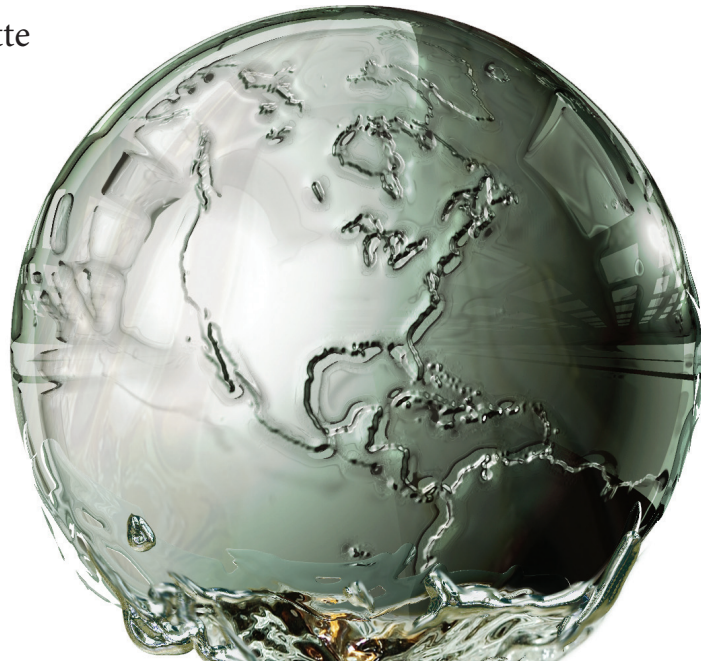
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The Care and Feeding of Plus-Sized Portfolios

As more companies develop an appetite for high-growth markets, portfolio management best practices are quickly emerging.

BY ANAND SANWAL

RECENTLY, I WATCHED AN INTERVIEW with Jeff Immelt, the CEO of General Electric, as he talked about the sale of GE's plastics unit to Saudi Basic Industries for \$11.6 billion. On more than one occasion during the brief interview, Immelt talked about the sale as part of a move to rebalance the company's portfolio. In this instance, GE was moving away from a struggling, low-growth, plastics business to focus on higher-growth areas.

GE is not alone in their effort to rebalance their portfolio. Some do it as GE did, by exiting slow-growth or poorly performing businesses, while some aim to get into faster-growing or synergistic businesses. And, in some instances, companies do both.

Pepsi, for example, exited and entered businesses as they shed capital-intensive businesses such as restaurants (Pizza Hut, Taco Bell, etc.) and entered high-growth segments like sports drinks and bottled water and bought Quaker Oats, where they could leverage their distribution assets and competencies. News Corporation sought a similar portfolio shift by entering the high-growth, buzzworthy social networking arena through their purchase of MySpace. While the postmortem on the Pepsi rebalancing has been positive, the verdict remains out on the News Corporation-MySpace pairing.

And then there are those instances where the rebalancing does not pan out as planned, e.g., AOL-Time Warner. Of course, there are numerous other examples of organizations

attempting such "portfolio repositioning" – some of which go well and some of which don't go so well. For business-people, strategies to rebalance the portfolio or reposition for growth do have an innate allure because they sound sexy and transformational and visionary.

And while this type of overall portfolio reexamination can make sense at times, it is merely one lever that companies have at their disposal to use for growth. But it is worth considering whether this is the best way to achieve an organization's growth objectives. By disaggregating the components of growth, it is possible to see and ascertain which dimensions of growth may be the most worthwhile to pursue.

Let us start by discussing market growth as well as inorganic/M&A growth. Several things should be readily apparent:

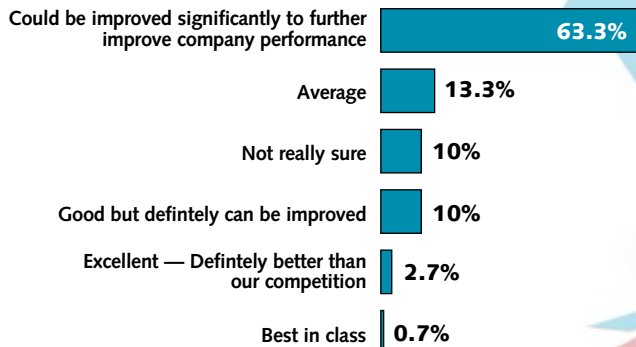
1. Market growth in the near term is really not under an organization's control. If you happen to be in an industry growing at double-digit rates, good for you. Conversely, if you are in an industry that is growing at a slow rate or even shrinking, too bad. The short of it in either case is that there is not much you can do in the immediate term to juice market growth. For example, the acquisition of MySpace will take some time to become material to News Corporation. So although you can think of entering segments that are growing faster, this rebalancing of your company's portfolio takes time. While sometimes critical, this is inherently risky and often expensive, as building or buying growth is not often cheap.

2. Inorganic/M&A growth is a strategy that some organizations and industries have pursued successfully to grow and that often accompanies portfolio rebalancing strategies. Overall, this is a strategy with a checkered past. Numerous studies and anecdotal evidence point to the uncertain results of M&As. While investment bankers may push M&As today only to later deconstruct those larger companies to "unlock

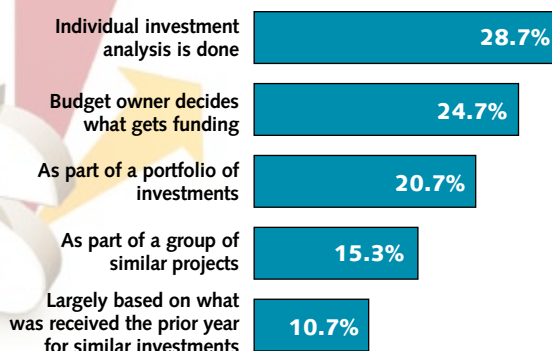
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THE CPM OPPORTUNITY: Where Resource Allocation Falls Short

How good do you feel your organization's current resource allocation capabilities are?



How are investments or project funding decisions made within your organization?



SOURCE: CORPORATE PORTFOLIO MANAGEMENT ASSOCIATION RESOURCE ALLOCATION SURVEY

value,” this strategy to grow is far from a given when pursuing growth and profitability over the long term.

With two of the four levers (market growth and inorganic growth) not easy to control in the short term and far from conclusively successful, the two remaining levers focused on controlling attrition and growing organically are worth examination (see chart page 34).

While these are not as glamorous as M&As or “positioning for growth” strategies, organizations that actively and appropriately manage these two dimensions can and do consistently grow and outperform their competition. Success in managing these two levers is a function of where a company allocates its resources. As a result, organizations that actively manage their resource allocation maximize their ability to deliver sustained growth. The other consequence of better resource allocation is that it gives shape to your true strategy, as strategy really is a function of where resources are allocated (and not a function of large strategic planning binders, PowerPoint presentations, or strategy platitudes by managers). In order to actively manage and optimize resource allocation, organizations should leverage an increasingly favored and impactful discipline known as corporate portfolio management.

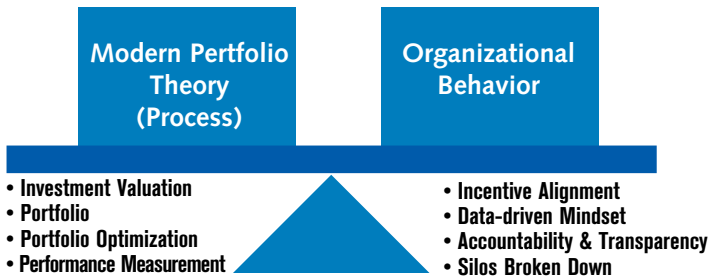
Already, several companies have begun to think about — and some have actually begun to deploy — corporate portfolio management. However, as with many management practices that become en vogue, a host of consultants and software providers have also emerged — many of questionable value. Just Google the term “corporate portfolio management,” and you get almost 16,000 responses. That’s a lot of information to sift through.

To save you the hassle of wading through heaps of information and misinformation on corporate portfolio management, let’s first understand the difficulties organizations face with regard to resource allocation that have necessitated and given way to corporate portfolio management as a discipline. To understand these difficulties, you don’t need to dig too far or too hard. Many organizations readily acknowledge that their resource allocation practices are sub par. The Corporate Portfolio Management Association’s (CPMA) recently concluded resource allocation member survey provides a very exhaustive view of the challenges organizations face when it comes to resource allocation (see chart above). My own research as well as the CPMA survey point to numerous very material deficiencies in the resource allocation processes organizations currently employ, namely:

- **Resource allocation** is reviewed infrequently (annually or ad-hoc reviews), with 60 percent of respondents to the CPMA survey admitting that much could be done to improve their resource allocation capabilities.
- **Personality and gamesmanship** are problematic, with decibel-driven decisions prevailing over data-driven ones.
- **Projections about the costs, benefits, and time of delivery of projects** are often wrong, with little or no accountability.
- **Despite the generally recognized importance of line and general managers to better resource allocation**, most organizations still primarily see resource allocation decisions made by executives.

The realization and acknowledgement of these resource allocation challenges has resulted in some organizations

CPM: A Balanced Diet



NOTE: CORPORATE PORTFOLIO MANAGEMENT IS OFTEN REFERRED TO BY DIFFERENT TERMS, SO AS A POINT OF REFERENCE, TERMS SUCH AS IT PORTFOLIO MANAGEMENT, ENTERPRISE PORTFOLIO MANAGEMENT, PRODUCT PORTFOLIO MANAGEMENT, PROJECT PORTFOLIO MANAGEMENT, RESOURCE ALLOCATION, AND INVESTMENT OPTIMIZATION ARE SIMILAR. IN FACT, THESE ALL ARE SLICES OR SUBSETS OF CORPORATE PORTFOLIO MANAGEMENT.

SOURCE: OPTIMIZING CORPORATE PORTFOLIO MANAGEMENT: ALIGNING INVESTMENT PROPOSALS WITH ORGANIZATIONAL STRATEGY BY ANAND SANWAL

openly indicating that resource allocation optimization and the adoption of corporate portfolio management is a critical goal for their corporations.

One notable example is Citigroup, where CFO Gary Crittenden announced to sell-side analysts on May 1, 2007, that resource allocation rigor was one of his primary focus areas. Merrill Lynch wrote after the meeting that “Crittenden seems disposed to be fairly ruthless in directing resources — capital, current spending — in favor of true growth while milking the cash cows; he’s pretty clear on the need to bal-

“(Citigroup’s CFO) seems disposed to be fairly ruthless in directing resources — capital, current spending — in favor of true growth while milking the cash cows; he’s pretty clear on the need to balance the long- and the short-term.” - Merrill Lynch

ance the long- and the short-term.” They go on to talk about the fact that he “appears appropriately cold-blooded in terms of what he calls a relatively ‘undemocratic’ approach to resource allocation.” Bear Stearns mentioned these measures as part of a “long-term goal of sustained organic growth.”

While Citigroup is in the formative stages of its corporate portfolio management discipline, there are also companies that have already developed best-in-class corporate portfolio

management disciplines from which we can learned. I chronicled five organizations in my book (*Optimizing Corporate Portfolio Management: Aligning Investment Proposals with Organizational Strategy*, John Wiley & Sons, 2007) that have all adopted corporate portfolio management in very different ways – HP, Cisco, American Express, TransUnion, and the State of Oregon’s Department of Human Services. All are quite progressive in their efforts, and research on these firms, coupled with other secondary research and interviews, yielded a useful working characterization and an understanding of what corporate portfolio management really is and how it can be enabled.

SO WHAT IS CORPORATE PORTFOLIO MANAGEMENT?

By removing many of the aforementioned hurdles to effective resource allocation, corporate portfolio management equips an organization with the ability to frequently and actively manage the company’s resource allocation as a portfolio of discretionary investments. It leverages data on projections as well as tracked actual results and actively involves investment owners in an effort that lets companies select the best investments to meet their strategic, financial, and risk goals.

Data and information are critical to removing the personality-driven elements of resource allocation. Ultimately, corporate portfolio management’s underlying belief is that, as the adage goes, what gets measured gets managed. To enable this measurement, corporate portfolio management relies on modern portfolio theory, but it is not so myopic in its use of data that it ignores critical behavior elements. As

a result, corporate portfolio management is predicated on and requires balancing two critical dimensions: modern portfolio theory and organizational behavior (See Chart on this page).

THE MYSTERY OF ORGANIZATIONAL BEHAVIOR

This is what people generally think of when they think of corporate portfolio management. It is composed of:

■ **Investment valuation.** This includes defining what an investment is. It is worthwhile to take an expansive definition of what comprises an investment because this is not just capital expenditures (capex), but also should include operating expenses (opex). In general, 25 to 40 percent of an organization’s expenses are discretionary and hence are investments. Investment valuation also requires consistency of valuation methodology, which necessitates using driver-based models to create projections, and

THE LEVERS OF REVENUE & INCOME GROWTH

- **Attrition** This is the revenue and income lost because of customers leaving your franchise. This is controllable and driven by your organization's resource allocation.
- **Market Growth** This is the revenue and income attributable to the growth of the market or industry your company participates in e.g., rising tide growth. It is highly unpredictable and uncontrollable by you.
- **Inorganic/M&A Growth** Revenue and income attributable to mergers & acquisitions. This is a risky and uncertain way to grow.
- **Organic Growth** Revenue and income earned by actively growing relationships with existing customers and/or acquiring new customers. Also achieved by innovating and launching new products in existing or adjacent market areas. This is controllable and driven by your organization's resource allocation.

also looking past NPVs and ROIs to consider strategy and other qualitative aspects that drive investment "value."

■ **Portfolio allocation.** This requires determining investment areas/themes and the associated allocations. Basically, what are my strategic priorities for investment and how much will go to each area? For example: 25 percent in customer acquisition, 20 percent in IT, 55 percent in customer retention. The allocation should also consider the risk profile

There should be a willingness and means to share information about investments across the organization, ultimately creating a marketplace for investments.

of investments, e.g., 60 percent in low-risk, 30 percent in medium-risk, and 10 percent in high-risk.

■ **Portfolio optimization.** This requires selecting the best investments to support the portfolio allocation and periodically rebalancing the portfolio to ensure consistency with desired portfolio allocations. The aim is to maximize strategic and financial return per unit of risk (not remove risk).

■ **Performance measurement.** A key element of successful corporate portfolio management is capturing actual investment results to enable promise vs. performance. Doing this ultimately lets an organization improve ongoing investment valuation based on actual results and allows it to rebalance the portfolio based on performance achieved.

Most people with a finance background will recognize the above tenets of portfolio theory. The problem with most of

the discussion of corporate portfolio management is that it assumes that people behave according to a theoretical/rational construct. While various experts like to offer platitudes by saying things like, "Just manage your company's investments like you manage your own investments," they fail to realize that many individuals may not even manage their own personal portfolios as they should.

We may know what we should do, but emotions, intuition, and other external influences take us off this rational path. What often leads us astray in our personal portfolio is what leads us astray in an organizational setting: behavior. The challenge in an organization is magnified by the fact that it is the behavior of hundreds or even thousands of people that needs to be considered.

So this is the second fundamental lever of corporate portfolio management: organizational behavior. In order to optimize your corporate portfolio, the required behavioral elements must be understood and enabled with:

■ **Incentive alignment.** People should be motivated by similar short- and long-term incentives because people will do what you pay them to do. If all of your incentives are short-term-oriented, line managers will run the business this way no matter how much talk there is of the long term.

■ **Data-driven mind-set.** Organizations often make decision- or intuition-led decisions, but corporate portfolio management, like Six Sigma, requires data-based and analytical decision-making. The aim is to balance intuitive and analytical decisions.

■ **Accountability & transparency.** There should be a willingness and means to share information about investments across the organization, ultimately creating a marketplace for investments.

■ **Silos broken down.** Corporate portfolio management success requires people thinking about what is best for the organization and not just what is best for "my world." Silos and organizational dynasties need to be broken down.

Moving organizational behavior is the larger challenge, and this takes time to change. American Express has emerged as having very enlightened practices in this regard. Their corporate portfolio management initiative has been recognized by the CFO Executive Board, Baseline Magazine (which calculated that Amex had a 2,700+ percent ROI), Gartner, and others, and the success of their efforts is due in some significant part to their understanding of the importance of organizational behavior.

To facilitate these changes, American Express conducted unit investment reviews enabling cross-unit resource real-

PORTFOLIO MANAGEMENT'S SEVEN (AND A HALF) DEADLY SINS

locations, sponsored an internal corporate portfolio management knowledge-sharing summit, and even created a resource allocation simulation to visibly demonstrate the benefit of corporate portfolio management to people in the business and finance.

With the tenets of corporate portfolio management understood, you now have a sense for what to focus on. It is critical as you embark on this path to avoid the missteps revealed in the CPMA survey and what I've deemed the seven and a half deadly sins of managing your investment portfolio (see chart on this page).

Ultimately, while "swing for the fences" efforts to rebalance the portfolio or acquire growth may be news- or buzz-worthy and are definitely sexy, they are highly risky and tremendously uncertain. And although there is undoubtedly an inherent allure in the idea of one visible intervention that will take you to the Promised Land, the question really is not whether it is worth it but whether it is necessary.

Is it necessary when managing and optimizing resource allocation can provide you with superior results? While optimizing resource allocation may seem drab, it is far from routine. It is an effort that allows a company to go from talking about its portfolio of businesses to actually managing its businesses as a portfolio of unique opportunities. It is these opportunities in marketing, R&D, IT, operations, etc., that have different, controllable financial, strategic, and risk benefits and that through proper management can really deliver consistent, above-market and above-competition growth.

Moving toward corporate portfolio management requires changing current decibel-/personality-driven, silo'd, sub-optimal investment decision-making methods to a process in which initiatives compete for resources and the best ideas are coveted and rewarded on the basis of data. In the end, the improved resource allocation enabled by corporate portfolio management offers a consistency of action, vision, and performance

that is currently only achieved by a small group of top-tier organizations. It is, however, something that all organizations with long-term growth as an aspiration should and can focus on. 📊

1. Narrowly Defining the Portfolio

Don't just focus on CapEx or IT

Think about operating expenses such as marketing, operations, R&D, innovation, sales force, etc as discretionary

All discretionary categories should be part of your resource allocation process

2. Investment Decisions are Like New Year's Resolutions

Do not review and make resource allocation decisions just annually or an ad-hoc basis

Resource allocation drives a company's strategy and should be reviewed on a frequent, recurring basis to ensure it considers changing business, industry and macroeconomic conditions

3. Decibel-driven versus Data-Driven Decision Making

Resource allocation decisions are often personality-driven

Leverage data-driven models to create a portfolio of investments based on facts and not flash

4. Too Many Metrics, Not Enough Time

Avoid the metrics hype

Don't lull your self into a sense of accomplishment by tracking too many metrics

Find those metrics which truly drive performance and focus your attention on those

5. One-Size Fits All Portfolio Management

Universal resource allocation frameworks or a single metric to optimize your portfolio do not work – do not make it all about NPV or ROI or any one metric

Different types of investments require different metrics and evaluation criteria

6. If We Install This Software, We'll Be Able to Optimize Our Corporate Portfolio

Technology can be an enabler of a portfolio management discipline, but it does not optimize for you

The process and behavioral elements need to be understood first – Technology comes down the road

7. It Is All about the Projections

Projections are important but you must track investment results

The tracking of results drives accountability and improves investment performance over time

7.5. Portfolio Management is a Tunnel – Not a Funnel

To be successful, underperforming projects or poor investment proposals must be killed

If your resource allocation is a tunnel in which everything makes it through, then the corporate portfolio management discipline is not useful – it is just bureaucratic

SOURCE: OPTIMIZING CORPORATE PORTFOLIO MANAGEMENT: ALIGNING INVESTMENT PROPOSALS WITH ORGANIZATIONAL STRATEGY BY ANAND SANWAL