# Attempting Portfolio Management

N. Dean Meyer

"Welcome, everybody, to the first Executive Portfolio Management meeting.  Thanks for coming.

"As you all know, I've been CIO here for seven years.  And not one year has gone by where you didn't bit… uh… complain about IT costs, and about not being able to control IT priorities.

"So as a result, we've implemented this new portfolio management process.  We're giving you control over our priorities, and asking you to manage the IT budget like an investment portfolio.  Sound good?"

"Sounds great, Frank.  How's it going to work?"

"Well, the keep-the-lights-on stuff like network connectivity, applications processing, and desk-top support is a given.  So you don't need to worry about that.  We're going to list all the big projects your people are asking for, and you'll prioritize them."

*[A moment of silence, then the torrent....]*

"Hang on, Frank, we need control of that keep-the-lights-on stuff too.  What if there are services in there that we don't really want?  We could shut them down and save some money to spend on things we really do want.  Or there might be services we want more of, or want higher levels of service on."

"And Frank, what about all those little 'maintenance' projects that are nickel-and-diming us to death?  Why aren't we managing those too?  Why just the big ones?"

"Now Frank, just rank-ordering the projects doesn't cut it.  How will we know how much we have to invest, and when we've run out of resources?"

"That's right!  Look, Frank, say we put things in order, A-B-C.  But what if we only have enough money for either A (a big project), or B plus C (two little projects).  Maybe B and C together are higher payoff than A alone.  If we don't know where the line is, how are we going to make these kinds of decisions?"

"Yeh, and Frank, you've got to give us more than a list of projects.  We need to know the full cost and the benefits to manage the IT budget as an investment portfolio.  Are you going to cost out everything?"

"Slow down everybody.  Look, IT is a complex organization.  We've got to keep things simple, right?  Getting everything costed is non-trivial.  So we're just going to give you the available developer hours, and we'll give you
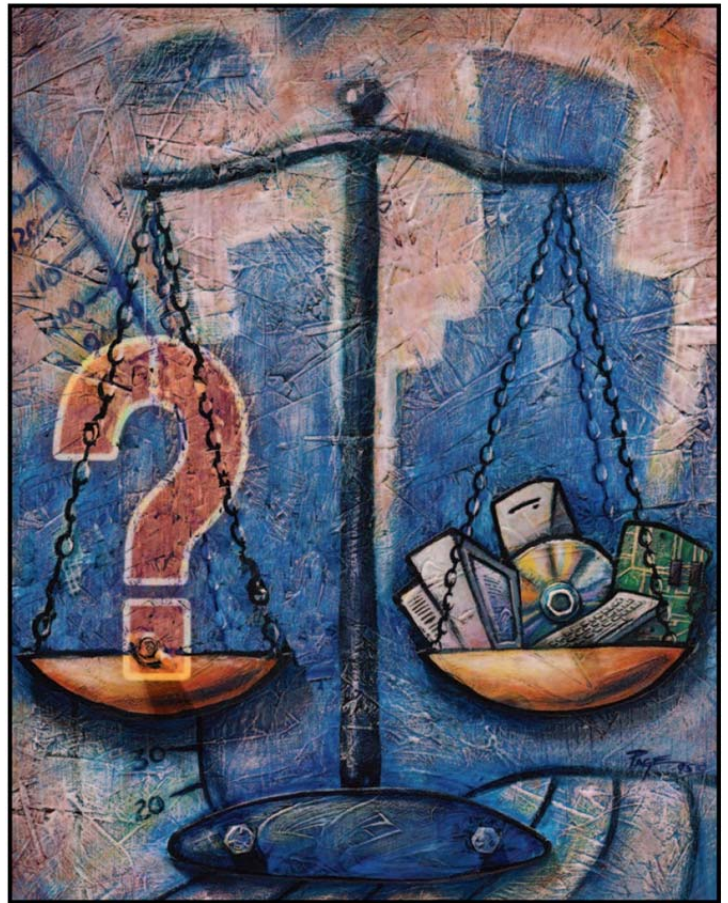
hour estimates on the projects.  So you'll know the number of hours you've got to work with, and you can invest them wisely."

*[Another moment of silence...]*

"Frank, are you telling us you don't know your costs???"

"We do know our costs… just not by product and service.  You know that's not the way we budget – costs by cost center and general ledger account.  You all do it that way, right!?"

"Hah, imagine if I told the CEO that my business unit didn't know its product costs!"

"Life in Corporate…. Must be nice!"

"Excuse me, Frank. I've got to run.  I'll send someone to the next meeting."

"Sorry, Frank, me too.  I don't think I can really help you here."

"Frank, I'll be blunt.  This is a farce.  Until you're ready to talk to us in business terms, in dollars and cents, this isn't worth my time."

## The Root of the Problem

You can't manage IT as a portfolio of investments if you can't calculate returns on investments (ROI).  And you can't calculate ROI unless you know the full cost of every project and service.

Clients have a sense of the payoff of the various investment opportunities (even if they don't quantify it).  But it's up to IT to estimate the true, full costs of all its products and services.

And that goes beyond just the big projects.  IT must be able to explain the costs of all its products and services, to show where its entire budget is going and what value it delivers.

With a budget that forecasts the costs of all deliverables, portfolio managers can know how much is in their checkbook, and can decide what checks to write.

It's as simple as this:  The ability to calculate the full cost of each and every deliverable is prerequisite to portfolio management.

## The Way Out

The solution is straightforward:  IT must plan its budget by costing its various deliverables (products and services), with rates set at true, full cost.  This is necessary whether or not IT charges back for its products and services.

"Full cost" means not just the time of applications developers.  Project and service costs include the "prime contractor" group plus all supporting internal "subcontractors" – project team members in other groups.  And each group has to assign not only direct costs (like people's time) to each deliverable, but also a fair share of all its indirect costs and overhead.

Full cost is necessary for three reasons:

One, it's required to understand ROI as a basis for investment decision making.

Two, it's necessary to know when the checkbook runs out, i.e., when the portfolio is fully invested.

Three, IT should never ask clients to pay for things they don't buy (like its overhead and fixed costs). They may very well choose not to fund those necessary indirect costs, in favor of their projects.

## Practicalities

The concept is simple, but the devil's in the details. IT is indeed a complex business. Some groups within IT serve clients, some serve others within IT, and most serve a mixture. Group A sells to B, and B in turn sells its services to A, creating complex circularity. Getting all costs assigned properly to the right deliverables is a tough challenge.

Some simple cost models utilize activity-based costing to assign all indirect costs to a catalog of products and services. But they calculate *rates*, not a budget. In fact, they take budget as an input, and ripple it into the rates.

A more powerful approach is needed – one that lists all the "sales" of each catalog item to all the various customers, both business units and other groups within IT. Then, a second-generation model is needed to recognize all those internal sales and get costs in the right place.

The tools has to be able to add up costs from all the members of each project team (the prime contractor and internal subcontractors). And it has to document pass-throughs as well as costs that go into rates.

And in the budget, you have to deal with speculative projects as well as the keep-the-lights-on services; so the final budget isn't known until after the budget is proposed.

With modern planning tools and methods, all this is not only possible; it's straightforward. And it's absolutely prerequisite to an effective portfolio management process. ❏

*For a library of information and case studies on investment-based budgeting, the method, and the tool, go to* fullcost.com. *And CIOs interested in a private sounding board on their resource-governance processes may enjoy a private consultation with Dean Meyer. Contact NDMA at 203-790-1100, or* info@ndma.com.