Why Companies Need Project Financial Intelligence

A UMT Whitepaper

By Mike Gruia, Chairman of UMT
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Traditional project financial management is flawed. A smarter alternative - Project Financial Intelligence can bring relevance and rigor in tracking and evaluating investments.

A growing number of managers today rely on project and portfolio management to help them oversee their investment portfolio. One of the consequences of this dependence has been the discovery that current financial management practices fall short of their intended goals. Results of a survey we conducted in September 2010 with leading U.S. companies indicated that almost 80 percent of those polled felt some level of dissatisfaction with their current financial management methods. Our initial findings suggest that some of the key obstacles causing this are rooted in knowledge deficiencies, lack of management support, and use of ineffective software.

Many managers fail to fully understand the impact of such poor financial management. They believe that the majority of investments don’t require financial evaluation; that intangible benefits provide a more than acceptable metric for success. This can prove a costly mistake, resulting in a poor track record of project selection and mismanagement of company investments.

Further complicating matters are CEOs, CFOs, and boards of trustees, facing a litany of economic challenges and corporate wrongdoings, finding themselves under an extreme amount of scrutiny as to how they should allocate their resources. As a result, they are demanding credible evidence of strong and achievable ROI before assigning dollars to projects.

Managers and executives alike would best be served by establishing strong Project Financial Management (PFM). But what type of PFM offers the most benefits? The richest most comprehensive PFM available in the marketplace introduces a new term we have created that serves as the basis for this article: Project Financial Intelligence (PFI). This paper defines PFI and its importance towards project selection and investment management. This paper also explores the cost of PFI illiteracy and the benefits from PFI use going forward. With a more detailed understanding of PFI, managers can better address their needs to finance the right opportunities and wisely manage their investments. This paper then concludes with recommendations on how to move forward.
What is Project Financial Intelligence (PFI)?

PFI integrates Project Management, Financial Management, and business intelligence (BI), providing valuable insight into project financials that significantly improves decision making and insight throughout the project lifecycle. The union of these different types of information represents a major departure from Project Financial Management (PFM) principles, processes, and practices. That’s because PFI focuses more on the details of cost and benefits estimating than PFM. The information is thorough, logical, and defensible. PFI also provides more insight into decisions. In addition, PFI integrates project and business domains and helps to improve governance.

How important is PFI?

Management expert Gary Hamel points out that over the course of the past 100 years, management innovation, more than any other kind of innovation, has enabled companies to cross new performance thresholds. In fact if you look closely at some of America’s leading companies such as General Electric, DuPont, Procter & Gamble, and Visa you would find management innovation at the core of their success. Interestingly, according to Hamel, almost all of the 20thcenturies most significant management innovations such as strategic planning, capital budgeting, project management, cost accounting and variance analysis, and ROI analysis all fall within the PFI classification.

PFI impacts most key economic organizational transactions including capital appropriation, capital spending, tracking, investment justification, cash flow management, funding, resource allocation, and chargeback. Considering that capital spending in the United States for example, equals approximately $1.38 trillion, companies could use PFI to better manage their business investments in projects and create a durable advantage that can impact the competitive position.

What is the cost of PFI illiteracy?

The Standish Group’s “CHAOS Summary 2009” report revealed that approximately 32 percent of all projects have successful resolutions (i.e. delivered on time, on budget, and with required features and functions). To put that figure in a proper perspective close to 140 billion dollars of the $200 billion spent by IT organizations in 2008 in US (based on US Census bureau) went towards failed projects or projects with unforeseen challenges.
The CHAOS Summary report also shows a direct correlation between budget and success. For example, whereas projects costing between $1 million and $3 million succeeded 38 percent of the time, projects that cost more than $10 million only had a 2 percent success rate. This correlation between rising cost and lower success rate provides a clear example of how flawed financial management contributes to the failure of so many projects. With the proper use of PFI, organizations have a much better chance of selecting optimum projects and realizing the anticipated benefits from these projects.

The benefits of PFI

PFI offers a valuable tool for many different aspects of strategic and operations management. Some of these include project selection and management, operations budgeting and tracking, and governance. The following sections illustrate how managers can best utilize PFI in these scenarios.

Improving project and portfolio decisions

A leadership team receives hundreds of project proposals to fill a certain strategic or tactical gap. Because of limited budget and resources, they can only choose a select few. So how do they create the optimal portfolio from the available options?

First, they must incorporate PFI into the process. Effective PFI drives action to approve, reject, or delay a project. To best utilize PFI, they should consider the following course of action:

- Develop project estimates top down or bottom up
- Assign cost and benefits to cost and profit centers
- Create financial metrics such as NPV or ROI
- Link strategic benefits to financials
- Optimize investments based on financial and strategic benefits

Once managers receive approval on a project, they can move their project into the execution phase. During this stage, businesses need to introduce performance controls to ensure the timeliness of a project’s completion, to deliver the project within budget, and to meet the financial benefits estimates.

Performance controls continue to the project’s conclusion. At each review phase, occurring monthly, quarterly, or in stages for example, the leadership team analyzes performance. This analysis helps identify at-risk projects and their root causes as well as evaluate trends and predictions that assess business impact. Based on this information, plans can be revised and action taken to rectify any issues.
Aligning project and business accounting

All project selection decisions impact an organization’s budgets and performance. When cost and benefits are assigned to responsibility centers, the assignments are based on the organization’s structure and needs for accuracy and granularity.

A vast flow of information exists between the project, the business, and operations domain. Initially, an organization must communicate its business direction. Next, thru a series of negotiations, organizations allocate, approve, and fund initiatives.

More and more organizations today incorporate a philosophy that encourages resource sharing. For example, a company may seek to share IT or marketing and capital investments. Sharing resources however, creates two large challenges: resource allocation and chargeback.

For resource allocation, organizations need to find a way of transferring the cost of shared resources from the unit that formally manages them to the one that consumes their services. The chargeback mechanism acts as a horizontal link between different organizational budgets in the company, keeping profit plans accurate and driving accountability.

PFI serves as the key enabler of the chargeback process. Some of the benefits include the following:

• Provides the input for fair resource allocation
• Enables the business unit that consumes the services to choose between internal or external sources
• Offers an insight into the resources consumed on a periodic basis
• Provides the cost basis for enabling to charge the business unit that consumes the services

Finally, with PFI, the organization that consumes the resources can use the chargeback bill to decide whether they still value the project benefits, if it wants to move faster and invest more, or should it shop around to find other providers. In this way, the consumer chooses to get the level of investment that they value the most. Meanwhile the provider aligns their services with what consumers want most.

Enabling better governance

A flood of corporate scandals combined with the recent harsh economic downturn have served to undermine the confidence in current management systems and controls. Despite the fact that information assets represent more than 50 percent of capital spending, most companies lack effective financial governance.

Governance strives to promote individual creativity within defined limits of freedom by using structural and control safeguards. Structural safeguards ensure clear definition of authority for individuals handling budgets, optimum processes and workflows and effective standards for managing cost and benefits. In recent years, auditing has been added to this category as well.

Control safeguards measure and ensure compliance and process effectiveness. Financial compliance measures the deviation from agreed rules, practices, and standards. PFI uses the project information to drive three groups of measurements: exceptions from rules, project commitment deviations, and process effectiveness.
So what should companies do?

This article is meant to serve as a wakeup call to managers that perform project and portfolio management. As such, managers will need to approach PFI implementation systematically with an action plan, a methodology, and the understanding of the required information technology.

Management teams need to take the time to assess their current situation. Identify the processes that use PFI and assess their criticality and capabilities. Determine the gaps between current realities and needs. Consider the order in which to close them. When ready to move forward, create a timeline for action.

Equally important is the project financial software that can significantly affect the analytical and collaboration capabilities. Companies can use this software to take complex data and transform it into intuitive information and visuals. Furthermore, when properly deployed, they can create useful collaborative environments to define workflows, deploy rules, and ensure that they are followed. Over time the companies that master PFI and the tools will come out ahead.

While PFI is not perfect, it's a huge improvement over unreliable alternatives. The combination of people and computational power presents unlimited opportunities. The quality of the project financials depends upon the sum of all project and portfolio financial decisions made by decision makers. The good news is that the quality of these decisions depends not only on the intelligence of the decision makers, but on project financial processes and methodology that can be improved and successfully deployed in your organization.

References

1. For a comprehensive review of the many usages of the Project Financial Intelligence, including software detail or demos visit www.projectfinancialserver.com.
2. To learn more about Microsoft Enterprise Project Management and BI solutions see www.microsoft.com/project.