Nine practices for better capital investment management

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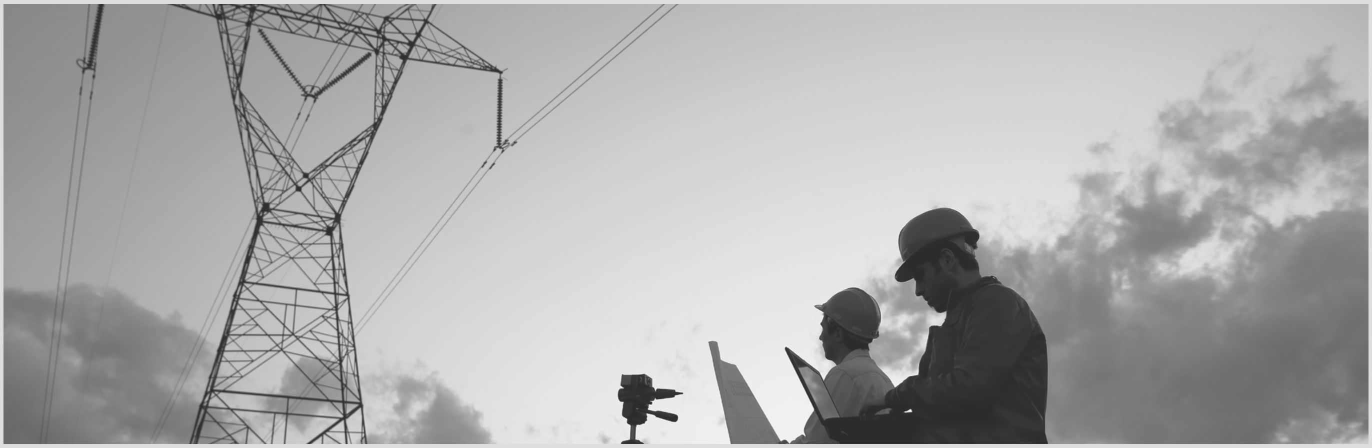

Across industries, senior executives know that managing capital investments wisely means better cash flow, faster growth and competitive advantage. Many organizations, however, struggle to manage spending on hundreds or even thousands of capital projects and miss substantial growth and profitability improvement opportunities as a result.

They can unlock this value and improve overall capital-investment performance by mastering nine practices and implementing a comprehensive digital capital portfolio management system.

1. Make the capital portfolio a priority

Capital-investment performance can have an enormous impact on an organization's value and it can drive growth and increase overall returns on invested capital. The best companies use a clear capital-allocation strategy to build winning portfolios. They link strategic imperatives to a target capital portfolio, setting and communicating targets for growth and productivity improvements and for sustaining capital expenditures (capex).

For example, when a leading utility generated an integrated view of its capital portfolio, it found that a large share of projects were classified as "regulatory," skewing the portfolio from its optimal mix. As a result, the portfolio over-weighted investments that offered little, if any, cash returns or enhancement of operational stability. With this insight, managers re-evaluated the portfolio, project by project, and removed discretionary elements that were bundled into the regulatory requirements. By freeing capital this way, they had more to spend on other cash generative priorities, such as increasing network reliability.

2. Tap the organization's collective wisdom

Despite an increasing amount of cross-disciplinary activities, recurring "stay in business" capital projects often still represent an engineer's solution to a business problem. Hence, the design of these projects often over-index on technical versus commercial attributes. Sourcing project ideas from experts across the business, including engineering, operations, and procurement, however, can bring the best thinking to the surface and help introduce more commercial inputs so that the portfolio is the best it can be for the business, not just technically. Digital tools that manage capex company-wide can facilitate this collaboration, improve transparency, and improve stage-gate reviews. Effective collaboration systems provide colleagues with all the information they need to track project activity, have productive dialogues and cross-pollinate best practices.

3. Set clear investment objectives and compare even seemingly disparate projects

Most organizations categorize potential investments either qualitatively or quantitatively. Qualitative investments typically include strategic projects or those that address new mandates or regulatory requirements. Most quantitative investments have clear financial goals.

To prevent "pet projects" from moving under the radar, managers should be able to compare and prioritize them on an apples-to-apples basis – even across disparate categories. One chemical company forced a management discussion to compare quantitative facts with qualitative rankings of its portfolio. The conversation led to informed tradeoffs on productivity, growth and maintenance categories, increasing portfolio net present value (NPV) by more than 30 percent.

4. Scrub the business case for each project multiple times throughout the life cycle

Every project proposal should include a detailed rationale, an explanation of alternatives, and a calculation of the expected return or qualitative benefit, timing, context and risk. Each aspect is likely to evolve as the project takes shape.

A standard model or system for identifying the sources of value of each project helps reduce uncertainties, eliminate cognitive biases and build an empirical foundation for portfolio optimization. Across industries, scrub-and-optimization processes commonly result in 10 to 30 percent reductions in spending for non-major projects.

5. Use ROI throughout the investment lifecycle

Companies must be able to track return on investment (ROI) across the project life cycle, particularly when planning a portfolio or annual budget and again when reviewing formal approval requests.

While the initial budgeting process should identify the most valuable projects, formal reviews allow managers to re-evaluate priorities and understand each project's rank as it unfolds. Calculating ROI is also critical in post-completion reviews, to understand how each investment performed against expectations, to improve future results.

Proper ROI analysis can drain resources, since it often requires support from finance. Leading companies adopt standard metrics and calculations, checking them with "scrubbing teams." The best use tools to calculate ROI automatically throughout the investment process – reducing errors, increasing transparency, and freeing up time for project managers and finance alike.

6. Streamline approvals and make contextually informed decisions

Capex approvers must tackle three questions when evaluating requests: Is this proposal complete and does it exceed minimum hurdle rates? Do we have the funds to invest in this project now? How attractive is this project compared with others?

They can take time to answer, delaying valuable projects. To invest in the most attractive projects and consistently hit targets, senior managers must assess each proposal quickly and easily given the capital position versus the budget and the alternatives. Decision authority must be streamlined. Many organizations require that too many people or functions be "consulted," inadvertently giving them pocket-veto power.

7. Forecast more frequently to enable tactical shifts

Many managers build a forecast process in a stand-alone spreadsheet – almost guaranteeing that forecasts are outdated by the time senior management sees them. Shortening this cycle requires several complementary advances:

- Actual data must flow automatically into the capital-management system so that project managers can easily and frequently update forecasts, and forecast roll-ups must be automatic.
- Forecasts must be compiled in a systematic and standardized way, and accessible from any device or location, to enable effective collaboration.
- Management must then act promptly based on these frequent, real-time forecasts – pushing tactical decisions down as far as possible.

As companies utilize digital tools to enable more frequent reporting and forecasting, they should work in parallel to become nimbler and more efficient.

8. Implement a unified cross-platform approach

Most organizations approve and deny projects in silos. Approvals may reside in a custom workflow application, for example, while actuals live in the enterprise-resource-planning system, and budgeting, forecasting, and ROI in a series of spreadsheets. Managers who must navigate multiple reports and databases may not have an accurate portfolio perspective, diminishing their ability to invest in the most attractive projects.

Companies overcome these limitations by adopting a capital portfolio-management system that is unified across the investment life cycle, from project inception to post-completion review. This can benefit other functions. For example, when a global manufacturer deployed a single digital tool for budgeting and project approvals, it gained visibility into capital spend across the organization and enabled the supply-chain team to identify significant savings opportunities.

9. Adopt a culture of continuous improvement

To maximize the value of their capital investment, organizations need to identify past errors and correct course. A clearly defined path to success can help.

If investment objectives are explicit and supported from the top down, managers know what they need to do to succeed – and cultural change can be relatively painless. In one company, leaders adopted a mechanism to flag projects over schedule or budget, instituting a formal review process for every project no matter how small, and tracked ROI by project and budget cycle to allow comparisons.

Using this approach, one oil and gas company steadily reduced capex budgets by several percentage points in the years after a step-change in performance without falling back to "business as usual."

Companies that follow these best practices can have dramatic results. One petrochemicals player with nearly $1 billion in planned capex per year faced significant challenges: an engineering-centric project culture that emphasized technical requirements at almost any cost, often sacrificing a strong link to business logic; an overly complex project-classification system that didn't allow comparisons; and disparate methods of defining and developing projects, thus preventing a single company-wide view of the entire project portfolio.

After establishing capital as a strategic priority in the face of externally driven pressure on cash flows, the company developed a simplified set of project-classification options, reducing them from 12 to four. It also established a standard project-definition taxonomy with a fit-for-purpose analysis of project economics, which allowed it to construct a "single source of truth" view of the company-wide project portfolio across more than a dozen business units. At the same time, the company also created an independent "capital-excellence" team with the express mandate of ensuring each proposed project was founded on a real business need and was cost efficient. In less than 12 months, the company delivered approximately 22 percent savings on in-year capex spend, with an increase of more than 70 percent in portfolio net present value as projects were improved and reprioritized. To sustain this improvement, the new capital-excellence team sat under the group chief financial officer and was given an ongoing mandate to continuously improve the way projects were developed and approved.

As companies focus on raising revenues and profits, a digitally enabled capital-investment management system can help to improve financial results and improve decision making so that today's projects are prioritized and selected with an optimal business target in mind.

Better capex management aligns investments more closely with the organization's strategy and reduces infighting in the struggle for funding. Furthermore, it allows project managers to make faster, fact-based decisions and gives senior leaders more time to focus on strategic issues.

In our experience, most organizations can institute a far more efficient and effective project-management process in four to six months and see project and portfolio NPV improvements of well over 10 percent within a year.

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