Maximize Growth and Minimize Risk by Managing Business Strategy Like an Investment Portfolio

Business-unit leaders and corporate executives are challenged these days to find the optimal path to achieve growth while managing risk. Companies have numerous options for expansion, all representing different levels of growth, profitability, and risk. Choosing well among all these opportunities—while also staying true to core competencies—can make the difference between stagnation and stellar growth. Consequently, when deciding which initiatives to pursue, and how to allocate limited resources among them, too often we don’t choose well.
But with the right tools, you can choose well. The framework in this paper outlines a process to help you find the choice that maximizes return, growth, and profit. It marries together the basic principles of Wall Street’s portfolio investment theory and net present value (NPV) with the risk management and strategy execution principles of project management. After all, your diverse array of business initiatives are all “projects” at their core, in need of excellent execution. Visualizing, assessing and rank-stacking your projects through this framework can be a powerful exercise.

To effectively manage your business strategy like an investment portfolio, it is critical that you:

- **Take risks confidently**: Make better decisions about which initiatives to pursue for your portfolio and which to kill
- **Improve the fundamentals**: Lead your organization to execute each initiative with operational excellence and maintain alignment with the overarching business strategy
- **Optimize overall returns**: Manage superior allocation of resources across your portfolio of business initiatives

Modern portfolio theory mathematically shows how the risk of a diversified portfolio is lower than the risk of the individual securities that go into it. It was first articulated in the 1950s by Harry Markowitz, who later won a Nobel Prize in economics.
Take Risks with Confidence

Risks Aren't Always a Bad Thing

The first step toward embracing risk is to realize that risks aren’t all bad, but they each come with positive or negative effects. In fact, the Project Management Institute’s (PMI) official Body of Knowledge (PMBOK) defines risk as “an uncertain event or condition that, if it occurs, has a positive or negative effect on one or more project objectives.”

As PMI defines it, positive risks are really opportunities. Therefore, effective risk management training helps you and your teams plan to exploit positive risk effects.

How to Embrace Risk

The second step toward embracing risk is to learn how to identify risks, quantify them, analyze their potential impact, and effectively plan for mitigating the negative effects and exploiting the positive effects.

Embracing risk is not hard but demands a strong constitution. Risk-management training teaches that your official budget should be viewed as a “base case” and be considered in the context of three additional scenarios: worst case, best case, and most likely. You differentiate among those scenarios by identifying the most impactful risks your business initiative faces and quantifying two things about each risk:

- The impact, in dollars, if it occurs, and
- The probability it will occur (see Table 1).

Once you determine those two values for each risk, you multiply them together to find the impact each risk will have on your business initiative. As you will identify positive and negative risks, the negative impact is called “exposure” and the positive “leverage.”

Risk Management in Action

A simple illustrative example should bring this risk management process to life. Table 1 shows three risks – two threats and one opportunity – identified for a factory-upgrade project budgeted to cost $3 million. The project manager estimates that if the company decides it needs additional production capacity after the factory upgrade starts, it will add $1 million to the budget; a delay in steel shipments would likely add $480,000; and perfect weather during the construction period would shave $750,000 from the budget. The PM has assessed all of these risks at low probabilities. Based on her assessment, the net budget impact is most likely to be $317,000.

| TABLE 1 |
|-----------------|-----------------|-----------------|
| **Risk Event**  | **Probability** | **Impact**      | **Expected Value** |
| Additional production capacity is required | 20%             | $1,000,000      | $200,000           |
| Weather is perfect during construction of upgraded facility | 10%             | $-750,000       | $-75,000           |
| Steel for upgraded facility is delayed | 40%             | $480,000        | $192,000           |
| **Total expected value for project** |                 |                 | **+$317,000**      |

Extrapolating from the table of expected values, Figure 1 charts four budget scenarios for the factory upgrade project, displaying the full spread of actual possibilities. The base case is the project budget: $3 million. The best case shows the cost if none of the threats occur but the weather is perfect: $2,25 million. The worst case shows the cost if both
threats occur and the weather is imperfect: $4.48 million. Finally, the most likely case shows what the PM really thinks will happen based on her expert assessment of the risks and their probabilities, as presented in Table 1: $3.317 million.

Given this spectrum of budget probabilities, and an understanding of the incremental returns expected from the upgraded factory, you can make a confident decision about whether to go ahead with the project after having a discussion with the project manager to reason out her assumptions behind the probabilities. Remember: risk and rate of return must be commensurate for a project to be worthwhile. High-risk projects should only be approved if they have high rates of return. But by assessing risks in the manner just described, and correlating them to expected returns, you can decide with confidence whether to pursue a high-risk project.

The Decisions Are Still Yours

Once you’ve used these methods to rank-stack the range of risk-adjusted returns for your various business initiatives, the hard choices about which projects to pursue are still yours to make. The analysis provides you with deeper knowledge and insight with which to compare different projects’ returns. It’s still up to you to compare the probable returns for each project, assess your organization’s ability to accomplish each one, weigh the risks, and choose where to invest your money, time and effort. Our third section leverages portfolio theory and capital budgeting principles to help you do so.
There's a reason why investors like Warren Buffett study companies’ “fundamentals.” It tells them which companies have the skills and executional rigor to consistently succeed. They don’t look for one-hit wonders or flashes in the pan; they look for companies with the fundamental strength to continue winning even as the economic environment and the very rules of play evolve rapidly around them.

Because of that rapid evolution, however – e.g., relentless technology innovation, growing customer power, globalization – continuous training is required to maintain your organization’s fundamentals. Recent research finds that 80% of the highest-performing organizations focus on continuous training, i.e., giving workers the skills they need to achieve exceptional performance.¹

Improving the way your people lead and execute project-based work means increasing the alignment of your execution to your intended strategy while reducing uncertainty associated with your business initiatives’ risks. The result? An upskilled workforce of project leaders, who seamlessly transition from “big picture” strategic thinking to attention to detail in work that effectively delivers against the defined strategy. Improved teams, capability, and capacity ensure greater success, greater growth, and greater revenues.

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Fundamentals to Focus On

There are five key skills that deserve the lion’s share of your attention because they have the most impact on strategy execution. By that we mean they will enable your organization to execute faster and with higher quality, while creating a level of repeatability that assures your organization can deliver high-quality results every time.

1. **Strategic Alignment:** Aligning execution with intended strategy is the overarching theme, and you will find that many of the subsequent core competencies fall under that umbrella. Train your teams to ensure that initiatives are aligned with strategy from beginning to end. That means:
   - Understanding and articulating overall organizational strategy, and the part a given initiative plays in delivering it
   - Applying and maintaining alignment of the initiative to overall strategy
   - Managing expectations of those who have a stake in the project outcome

2. **Project Management:** You may or may not have professional project managers on your payroll, but your business initiative leaders could all benefit from project management skills. Your business initiatives can easily be viewed as a series of projects – and it happens there is a large body of art and science around the discipline of project management that drives projects to achieve greater success, faster. Project management training will help your teams:
   - More effectively align business initiatives with overarching corporate strategy
   - Build better plans, faster, and with a deeper understanding of all their components
   - Execute faster and more cleanly against those plans
   - Anticipate potential roadblocks and risks faster
   - Develop “relational” skills – interpersonal skills that reflect leadership ability such as negotiation and facilitation skills, persuasiveness, change management, and the ability to communicate up, down, and across the organization
Risk Management: As already discussed, a thorough assessment of all the risks that could interfere with your initiative’s success is of paramount importance. But of even more critical importance is actively—and in the best case, proactively—managing identified potential risks, and being prepared to address the unexpected. To proactively manage risk, here are the key areas on which to focus:

- Identify market variables that could impact your initiative’s success, and monitor them regularly
- Identify deliverables whose delays will have a cascading effect on the rest of the project (internal interdependencies)
- Continuously monitor for all of the above, and raise a red flag at the first sign of trouble
- Develop contingency plans, so that when unanticipated issues arise no time is wasted

Communication: Mistakes that impact executional speed and quality often happen because someone didn’t communicate effectively enough. Ensure your initiative leaders are trained to communicate expectations and responsibilities clearly and precisely, so teams know they are accountable. Communications training helps:

- Initiative leaders effectively articulate the “big picture,” so their teams make decisions in alignment with business strategy
- Foster an atmosphere of over communication, to ensure that no one is afraid to speak up or ask questions
- Clearly define who is accountable for assignments and deadlines
- Establish regular, and “interrupt-driven” (i.e., when bad stuff happens) communications

Change Management: Finally, with every initiative you undertake, something’s going to change. Don’t shy away from it, meet it head on. Whether you’re making a large or small transition, resetting a strategy, or acquiring a company, assess the impact on various elements of your organization, and address it quickly and forthrightly. Change management training helps your team:

- Develop an overarching approach for making change happen in your organization
- Articulate a compelling vision for each change
- Engage stakeholders in support of the change
- Develop a communication plan for change initiatives
- Manage employees’ emotional reactions to change

Improve your teams’ fundamentals and you will reduce risk, better understand the risks you do face and how to mitigate them, and always execute in alignment with your organization’s strategic intent.
Conclusion: Even Better Than Portfolio Investing

This white paper presents a detailed argument for why you should use a portfolio investment approach to decide among the myriad business options open to you, along with the do-it-yourself instruction and examples we believe will help you to do so. It comes down to how understanding your risks and your true overall returns puts you in a far better position to look at all your initiatives and make decisions about which ones to invest in and how to align them into a total portfolio.

But unlike an actual investor, you are not a buyer of stocks and bonds. You are a corporate or business-unit executive who can directly impact the quality of execution and, therefore, the outcomes.

Think of yourself more like an activist investor. And the more actively you pursue a strategy execution approach, the better your organization will execute your initiatives, see lasting growth.

References