Gartner

Use Zero-Based Prioritization to Refocus Portfolios on Strategic Business Initiatives

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Initiatives: Executive Leadership: Cost Management **and 3 more**

The spread of COVID-19 will force budgets to be curtailed, however demand for new initiatives keeps growing. By following the principles of zero-based prioritization, executive leaders can rebuild their portfolios and free up scarce resources for investments in new strategic business initiatives.

Overview

Key Challenges

- As organizations prepare for changing business conditions due to the spread of COVID-19, they face tremendous pressure to cut costs and restrict budgets, but demand for new initiatives keeps growing.
- Circumstances may change after initiatives launch, but many organizations lack the mechanisms to ensure that their in-flight projects and other work efforts are on track to realize benefits.
- High-priority initiatives are often delayed due to a lack of funding; the absence of in-progress project valuation to changing strategies adds to the cash flow issue.
- Some organizations lack a logical, systematic way to periodically evaluate and prioritize their portfolios, which may lead to funding of the wrong types of initiatives.

Recommendations

Executive leaders responsible for planning, budgeting and controlling costs across the enterprise must work with their direct reports to:

- Use a framework to analyze their portfolios by prioritizing initiatives based on business goals and outcomes, and categorize them into groups for mandatory, transformation, core differentiation, growth and improvement investments.
- Reset the portfolio to zero by clearing all current work efforts and new requests.
- Collaborate with peers to add back work efforts based on the priority level of projects until they reach the agreed target.

- Finalize the portfolio by postponing or cutting all initiatives that haven't been included. Resolve any disputes by double-checking the classification of all mandatory, transformational and core projects.
- Aim to adopt zero-based prioritization, particularly during periods of significant change or where an in-depth review is warranted to cut any costs no longer supporting the strategic direction of the organization.

Introduction

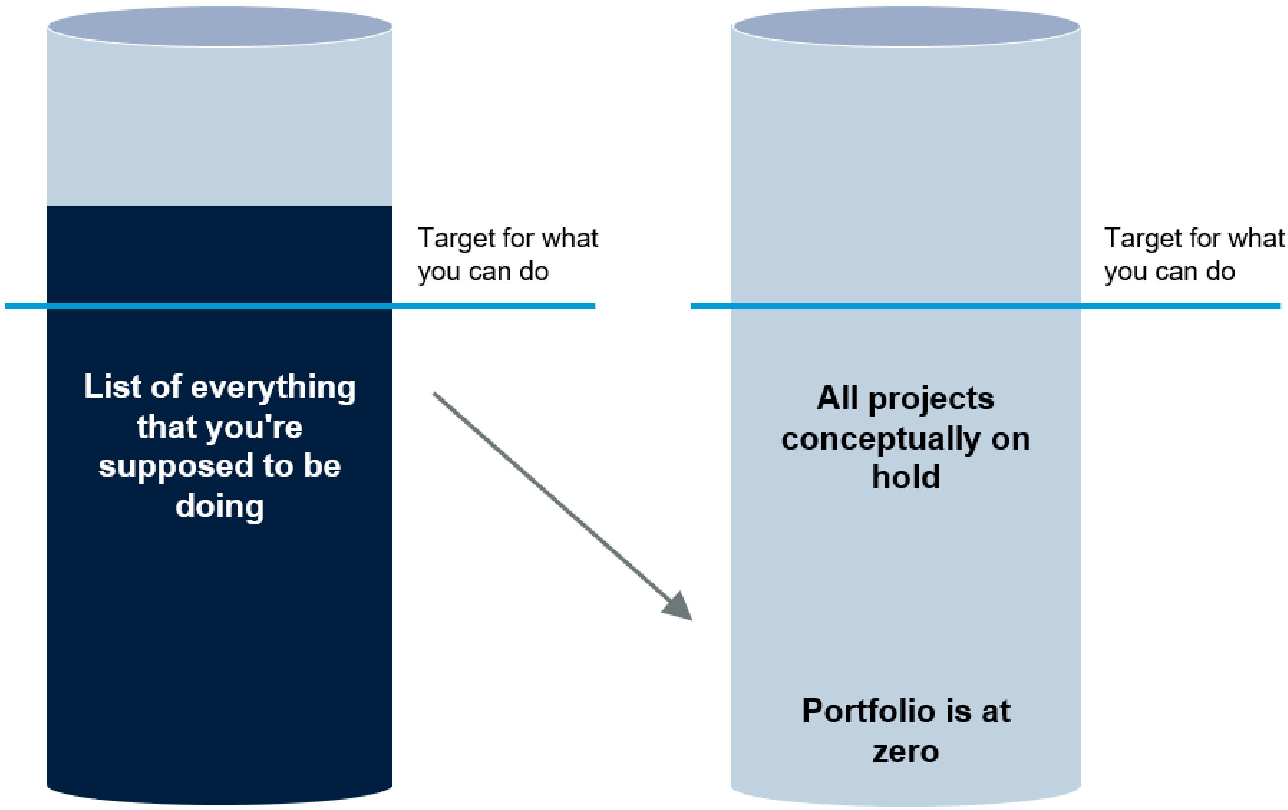
With a finite budget for initiatives, a backlog of postponed investments in the pipeline can make it seem impossible to accept any new initiatives or requests. Many budgets are tied to existing initiatives (projects, programs, products or services) that the organization approved in the past and haven't been completed. When it's time to renew a portfolio, the traditional practice has been to take the existing investments for granted. The focus has been on the overlap between the previous portfolio and any new proposals. This is based on the logic that whatever the organization spent before is still valid. However, this focus on incremental change limits the influence that budgetholders have on the total portfolio of demand.

The challenge is especially difficult when organizations are undergoing a major change in strategic direction due to significant reduction in revenue, disruption in supply chain and depleting workforce as a result of a crisis, such as the spread of COVID-19. Many of the existing improvement initiatives are likely to address performance problems that are no longer relevant to the new direction of the business, because planning assumptions have changed. To prepare for the impact as COVID-19 spreads, organizations must critically evaluate all their strategic business initiatives.

To avoid a cost-cutting reflex, executive leaders responsible for planning, budgeting and controlling costs must challenge existing initiatives and levels of spending to enable a thorough examination of the total portfolio. They should use the principles of zero-based prioritization (see Note 1) in a one-off exercise that starts by putting all initiatives (i.e., projects, programs, products or services) on hold and bringing spending conceptually down to zero (see Figure 1).

Figure 1. Framework for Assessing Priorities

Framework for Assessing Priorities



Source: Gartner (April 2019)
ID: 381082

This uses a zero-based budgeting model. Although zero-based budgeting is too heavy a process to repeat regularly, its basic principles provide an effective framework for a one-off reset of a portfolio. It can provide much-needed flexibility to free up resources for new strategic investments. [1]

Executive leaders should continue to use more-traditional, continuous-planning practices to fine-tune their portfolio each year. Zero-based prioritization as a practice is particularly useful in a crisis or when there is a transition of senior management and the new leader(s) want to establish an in-depth understanding of what's in the budget and the value these costs are driving.

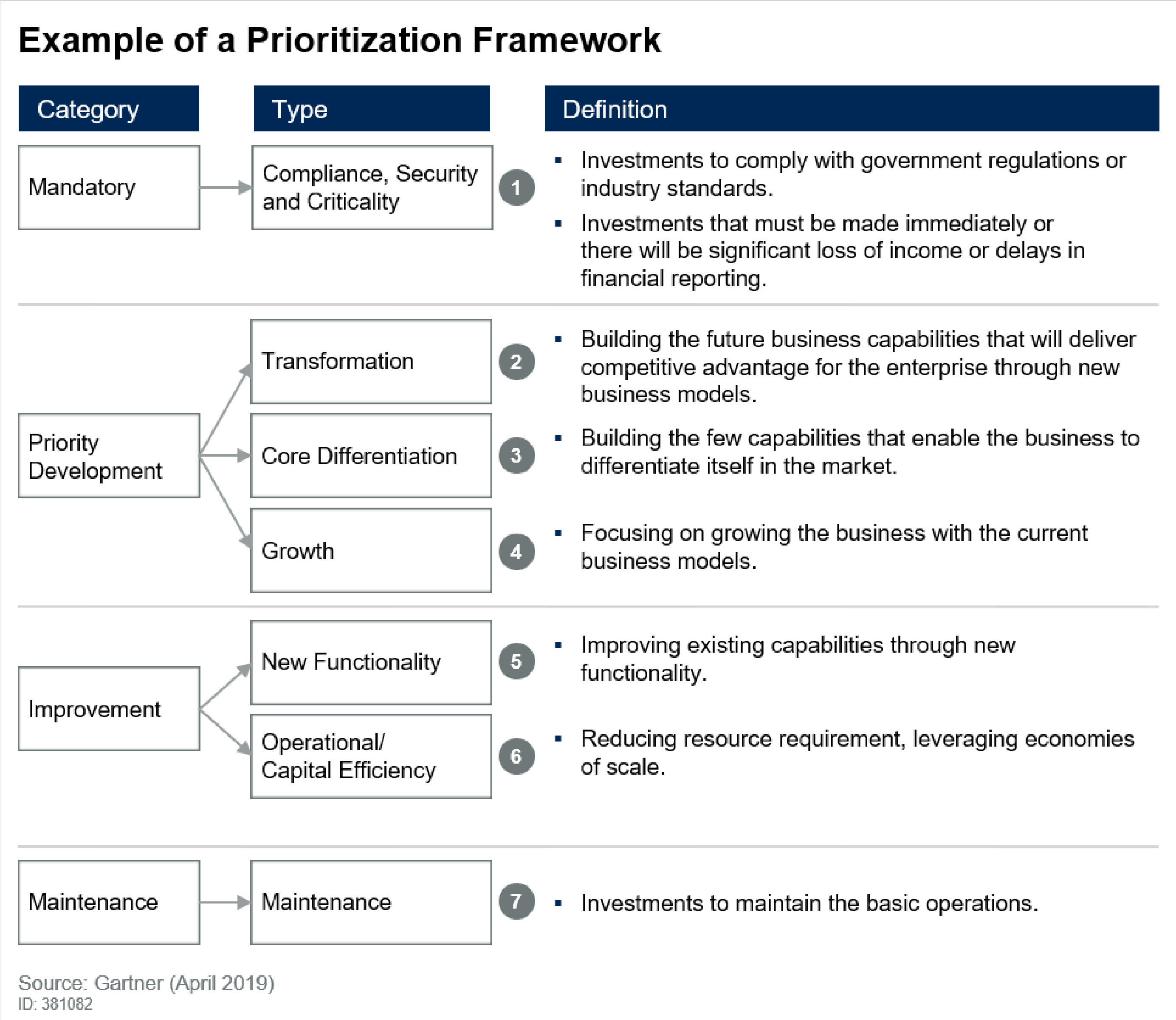
Analysis

This research is adapted from "How PPM Leaders Can Use Zero-Based Prioritization to Refocus Their Portfolios on Strategic Business Initiatives," in which program and portfolio management leaders are advised to rebuild their portfolios using principles of zero-based prioritization to free up resources for investments in strategic business initiatives.

Agree on the Framework and Set the Target for Spending

Organizations have little flexibility to respond to new strategic demand if legacy projects fill the portfolio. As organizations face pressure to reduce costs, executive leaders must reset the portfolio through zero-based prioritization to free up resources for strategic initiatives. They must use a framework to analyze the portfolio by comparing all new and existing projects in a similar way to assess priority and business value (see Figure 2).

Figure 2. Example of a Prioritization Framework



Executive leaders must use the organization's existing framework consistently, with the classification logic familiar to project managers and key decision makers. If the organization doesn't have an adequate framework, then executive leaders must adhere to the following best practices to develop a framework for assessing the value and priority of projects:

- Base the evaluation criteria on business drivers, such as financial performance, product quality or business project performance.

- Use the same financial evaluation measures across the business because they will be easy to understand and familiar to people.
- Include risk assessment as one of the criteria in the framework — risks can easily reduce the expected ROI of a project.
- Use weighting across assessment criteria to reflect relative importance.
- Assess the dependencies between programs and projects to analyze how postponements or cancellations may affect a portfolio.

Executive leaders must work with their direct reports to identify five categories of projects, regardless of the specific criteria used to classify them. These categories will provide guidance for rebuilding the portfolio from zero:

- **Mandatory.** These projects must be done and shouldn't be confused with "very important projects." Ensure there's a clear understanding of what a mandatory project is. Typically, mandatory projects comply with regulatory requirements, or resolve an issue that would otherwise lead to significant loss of sales, delays in invoicing or delays in financial reporting.
- **Transformation.** These projects build the future core competitive advantage of the organization. The projects in this list must link explicitly with the organization's strategy and focus on creating new markets or business models.
- **Core Differentiation.** These projects build the capabilities that enable the organization to differentiate itself in the market. Ensure that there's a clear understanding of what belongs in this category. Typically, an organization has only a few areas of core competitive advantage, so don't treat this as a catchall category for any project that links to the strategy. Ask peers to clarify which capabilities provide core competitive advantage, and ensure that all participants in the decision-making process share the same view.
- **Growth.** These projects focus on growing the business within the current business models.
- **Improvement.** These projects seek to deliver operational or capital efficiency. This category also includes projects that provide maintenance or basic improvements.

Executive leaders must agree on the framework and then clarify the target portfolio spending levels. The fundamental principle of the zero-based prioritization process is to work from zero and build the portfolio up to an agreed-on target. The target will probably have been set already as part of the corporate budgeting process. Executive leaders must communicate the target to everyone involved at the outset, so that everyone is clear about the cutoff point after which further activities in the portfolio won't be allowed.

Announce a Theoretical Stop to All Initiatives for the Next Budgeting Period

Executive leaders must start the zero-based prioritization review process by clearing all existing projects and activities, as well as all demand that has already made its way into the portfolio (see Note 2 for communication tips). To make the process effective they must consider two key points:

1. The act of bringing the portfolio back down to zero must focus on the "to be" portfolio. Don't stop projects and activities that are already running — the budgeting process shouldn't interfere with ongoing execution. Decision makers must take actions on what will stop, start and continue only after the zero-based prioritization process is complete.

2. Zero-based prioritization brings a fundamental change in mindset. Decision makers no longer need to justify why they're stopping an activity. Instead, with the portfolio now empty, they must justify why an activity should be allowed back into the portfolio.

Build the Portfolio Back Up, Piece by Piece

The next step represents the core of zero-based prioritization. Executive leaders must work with their direct reports to assess and classify all projects based on the agreed-on framework, and build the portfolio back up from zero, piece by piece, until it reaches the target. Once all projects are classified and ready for review, they must collaborate with key decision makers to agree on what should go back into the portfolio. The decision makers must be confident in the projects approved for the portfolio before they can agree on which projects to cut.

Executive leaders must work with their direct reports and follow these steps to build the portfolio back up, based on each level of priority (see Figure 3):

- **Bring forward all mandatory projects and their associated costs.** Review them and ensure that the decision makers agree on the reasons why each project is classified as mandatory.

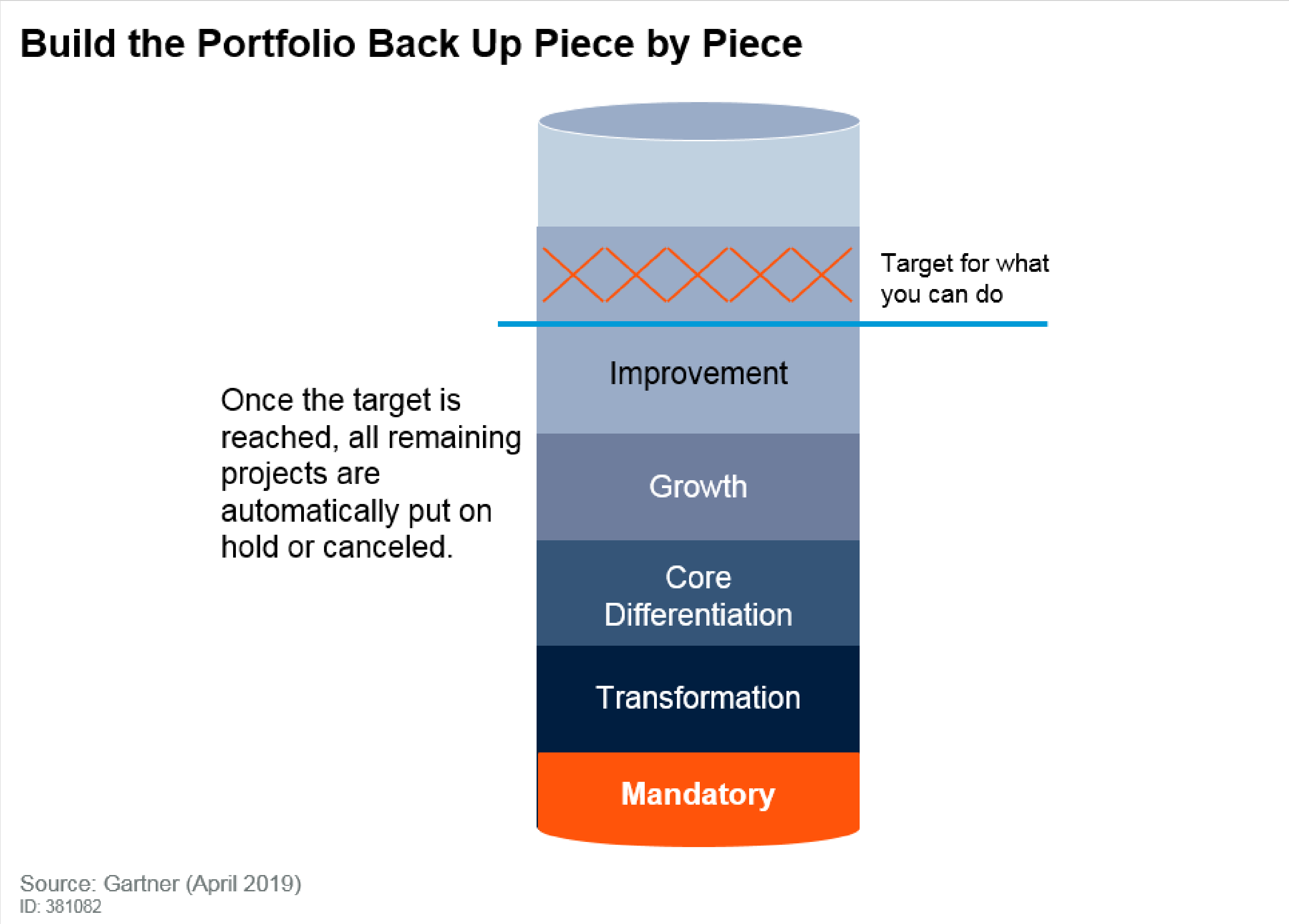
- **Add in the transformation projects.** These must derive from the organization's strategy. They must build the organization's future competitive advantage. As such, they're a high priority for sustainable success.

- **Add in the core differentiation projects.** Check these against the business strategy and the agreed-on definition of the capabilities that provide core competitive advantage. Verify that each project focuses on strengthening competitive advantage. Don't give high-level priority to a project that will add "nice to have" features to a core capability.

- **Add growth projects into the portfolio.** Check these against the business strategy to ensure that they explicitly deliver a strategic objective. Although these projects are important, assess them closely, using the agreed-on framework to ensure that only growth priorities with measurable business value are approved.

- **Add in the remaining improvement projects.** Because these projects target improvement in efficiency and effectiveness, assess business cases following the agreed-on framework, and rank projects in order of investment.

Figure 3. Build the Portfolio Back Up Piece by Piece



Finalize the Portfolio, and Resolve Any Disputes

Executive leaders must finalize the portfolio, and postpone or cut any activities that haven't been included. Ideally, at this point, they should capture all of the must-do activities in the portfolio. So the last decision-making stage focuses on selecting the best-value strategic or improvement projects that will make it into the final, approved portfolio.

In some cases, projects that don't make it into the final portfolio may still have strong pressure from their business sponsors to continue. As a result, business sponsors will often propose funding the project from elsewhere. This could be a viable option, but it's important to consider the following risks before agreeing. This approach will create an artificial sense of reduction in spending. The reality is that the spending simply shifts from one corporate pocket to the next, and the total amount doesn't decrease. This may be an attractive short-term solution, but it doesn't address the original challenge of reducing total spending.

Projects Near Completion That Haven't Made the Portfolio

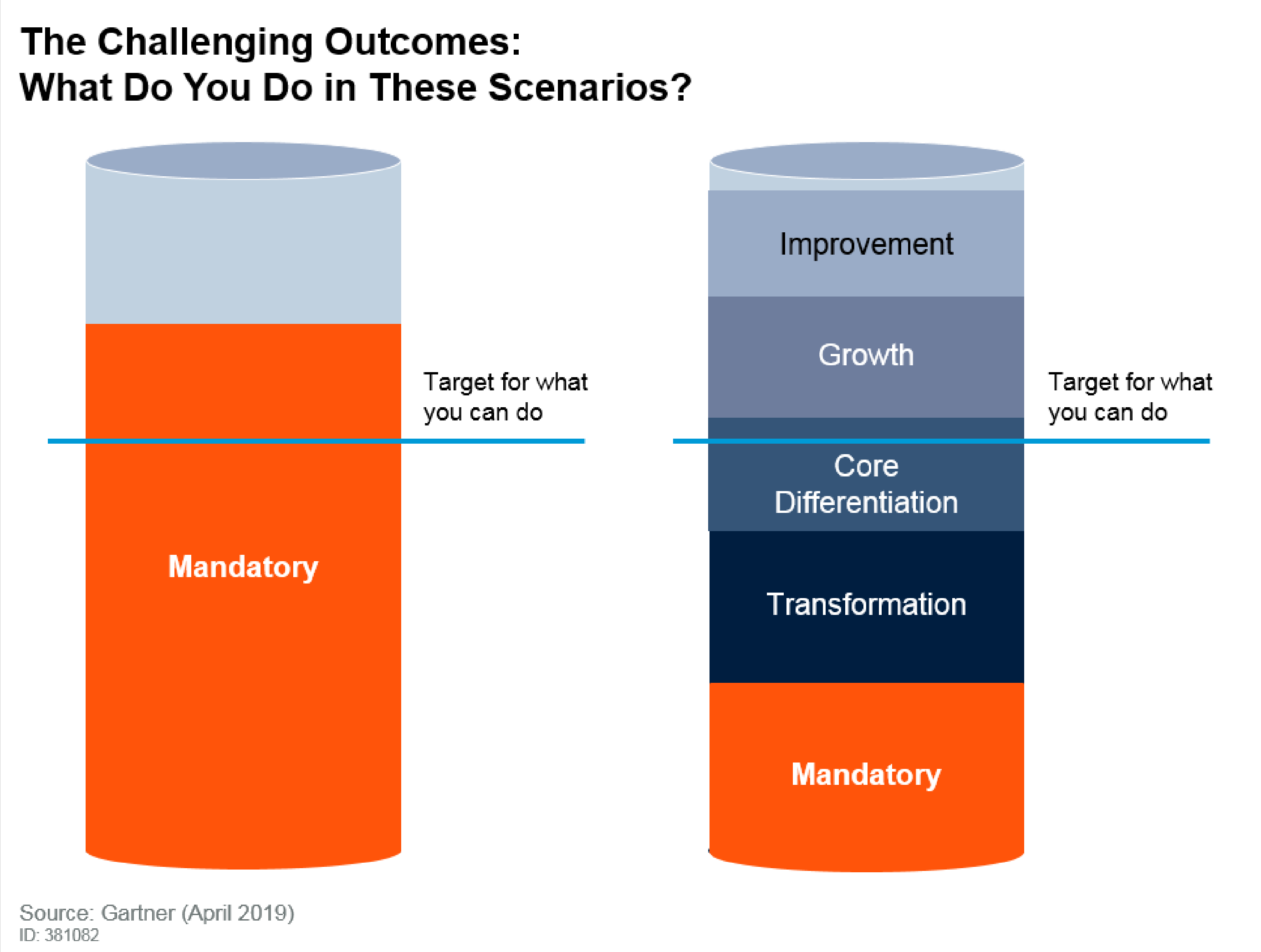
Executive leaders must decide what to do with projects that are near completion, but haven't made the final portfolio. It may not make sense to stop a project just before the point of benefit realization, when considerable time and resources have already been invested in it. However, it's equally important not to allow a project to continue simply because it has been going on for a long time. Circumstances may have changed since the project started. If this is the case, that change may have affected the potential for benefits, and spending even more money on the project may not be wise. Executive leaders must consider money spent on projects that haven't made it on to the list of priorities as a sunk cost. They must decide whether to allow them to finish, even if they are near to completion, by assessing the expected benefits and the relative importance of completing the project, compared with projects already identified as high priority. It may be worth completing some projects, but executive leaders may need to stop others in favor of more-pressing investments.

After adding the final projects and reaching the target, executive leaders and other key decision makers should officially approve the renewed portfolio. When they've done so, communicate the projects that have approval to continue and the new projects that will be added. Cancel or postpone all other projects and activities that didn't make the final portfolio until the next budgeting round.

Unexpected or Challenging Results

In most cases, the zero-based prioritization process will lead to logical conclusions on what to leave in the portfolio and what to take out. However, executive leaders may face some unexpected or challenging results that require revisiting the prioritization decisions. There are two potential challenges that may need to be resolved (see Figure 4).

Figure 4. The Challenging Outcomes: What Do You Do in These Scenarios?



Too Many Mandatory Projects

If most projects are classified as mandatory, or if the list of mandatory activities exceeds the target, consider the following options:

- Revisit the definition of "mandatory." It may not be clear enough to highlight the activities that organization must do now.
- Review and challenge the mandatory activities again. Do so by asking the following questions:
  - Are the activities categorized as mandatory all critical to do one of the following:
    - Comply with regulations?
    - Protect against loss of information assets?
    - Resolve an issue that would otherwise lead to significant loss of sales or delays in invoicing or financial reporting?

- Do all of them need to be done now, or could some of them be deferred?

If the revised list of mandatory activities still exceeds the budget for the portfolio, then executive leaders must revisit the cost target. They'll have a compelling case for raising the cost target, with a solid set of data to justify it.

Too Many Transformation or Core Projects

If the portfolio is made up of only mandatory, transformation or core projects, and these still exceed the target, consider the following options:

- **Examine the list of transformation projects.** Ensure that they all link explicitly to the strategy for future competitive advantage. Check that these projects create the required capabilities for new business models or markets.
- **Revisit the list of core capabilities.** Ensure they bring competitive advantage to the organization. Check that they differentiate the organization in the market.
- **Review the list of core projects.** Assess whether they are all fundamental to strengthening the core capabilities. Determine whether any projects add only nice-to-have features to the core capabilities.

If the revised list of transformation or core projects still exceeds the target budget for the portfolio, executive leaders will have a compelling case for raising costs, with a solid set of data to justify it.

Assess the Merits of Extending the Zero-Based Prioritization Approach

Depending on the environment, executive leaders may want to consider extending this approach for more value in the decision-making process. They can do so by creating two additional scenarios for the budget using zero-based prioritization:

1. **Create a what-if plan based on 10% less of the target budget.** Decide which additional projects would need to be cut to meet this stricter target.
2. **Create a plan for exceeding the target by 10%.** This will identify the projects that are next in line, in case circumstances change. It will also communicate the additional value that would come with an increase in investment.

Evidence

[1] "The Return of Zero-Base Budgeting," McKinsey & Company.

[2] Pyhrr, Peter A. "Zero-Base Budgeting: A Practical Management Tool for Evaluating Expenses." John Wiley & Sons. September 1977.

Note 1: Zero-Based Budgeting

Zero-based budgeting first appeared in the early 1970s. Organizations used it as a dramatic tool to revisit and challenge all costs during annual budgeting rounds. It began as a specific solution to a specific business challenge at Texas Instruments. However, it became most popular in the government sector, first with the U.S. state of Georgia, and then with the U.S. federal government. [2] Although zero-based budgeting proved too heavy a process to repeat regularly, its basic principles provide an effective framework for a one-off reset of a portfolio. It can provide much-needed flexibility to free up resources for new strategic investments.

Note 2: Communication Tips

Open communication is important to the zero-based prioritization process, because executive leaders will need to engage a number of people throughout the organization to gather the necessary information. However, the message communicated is critical to the success of the process. Make it clear that this process aims to clarify priorities for the coming budgeting period, not to cause immediate disruption to current activities. Ensure that everyone knows that any final decisions that result from the prioritization process will be communicated, and that the resulting actions will be properly planned and managed. People must view this as a rational decision-making process, based on facts, rather than a secretive management exercise with a hidden agenda.

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Tool: How to Overcome the Three Major Cost-Cutting Mistakes

Supporting Initiatives

Executive Leadership: Cost Management

Track

CIO Leadership of Strategy, Governance and Operating Models

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Cost Optimization in 2020 Resource Center

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PMO Evolution for Digital

Track