Portfolio Decisions

In order to rank any list, one first needs to decide upon the SINGLE measure used to determine the position in the list.

It quickly becomes apparent that there is no single criterion that is suitable for ranking a list of potential opportunities in a business portfolio. Thus a custom calculated scale using a set of criteria with associated individual weighting is used to create the single measure.

Experienced portfolio managers find that the formula developed during one period of the business is rarely the best scale at later times. In fact the most robust strategy is to use a process where the criteria are reevaluated on an ongoing basis, and the overall weighting and summation modified accordingly.

So robust Portfolio Management becomes a two step process:

1. Determination of the selection criteria
2. Ranking of the projects in the queue

See the White Paper - Portfolio Management as a Process Not a Numbers Game for more details on the robust process highlighted in this Newsletter.

The number of criteria are many. Unfortunately some of them are so much part of existing processes, we find that it is traumatic to even question them. Selection of criteria is made with the understanding that the key business issues are being evaluated.

A partial list of issues can include:

- Cost
- Capitalization required
- Additional staffing required
- Income
- Timing
- Potential Downside Risk
- Potential Upside Success
- Quality of life
- Alignment with overall business
- Alignment with current core competencies

It is important to understand that the issues rarely have direct metrics. Therefore we use various measures to estimate how the particular

Measures which are typically applied include:

- Net Present Value – NPV
- Internal Rate of Return - IRR
- Projected Capitalization
- Projected Payback
- Multiplier (Total Net Income/Total Capitalization)
- Time to 50% Income
- Risk Assessment
- Benefit Assessment
- Strategic Alignment
- Tactical Alignment
- Goldratt's Flush

This is not a complete list, but it conveys the point that one has a lot of measures to choose from.

The unique part of the Portfolio Management process used by Velocity Pointe is the scoring process for the opportunities in the portfolio. Each selected measure is given a scale from 0 to 100 where 0 is the best, and 100 totally unacceptable.

As an example Risk may be divided into 5 levels: none, low, medium, high, excessive and unacceptable. The relative scores for these levels would be 0, 20, 40, 60, 80, and 100. If this is one of 5 or so measures to be applied, the weighting factor may be 10%. Thus a medium risk would contribute 40 * 10% = 4 units to the total score.

When all of the results are added together, the perfect opportunities will be 0 and the worst possible case a 100. One modification is made to the scoring. For all individual criteria, if an unacceptable criterion is encountered, the contribution is a full 100 and no weighting is applied. This creates scores of over 100 for any opportunity that has ANY criterion in the unacceptable range.

The final scoring removes all 100 points and above prospects and then subtracts the score from 100. The final calculated metric is a 1 to 100 score for ranking where 100 is perfect and all unacceptable prospects are removed.

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