

Evaluation of Strategic Initiatives

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This paper explores the basic dimensions for evaluating project initiatives in your organization – the strategic alignment, the economic value, and the associated risk.. Together, these three dimensions form a cohesive view of the initiative.

Introduction

Earlier in my career, as the senior executive in charge of strategic planning for a movie theater circuit, we worked on a scorecard to be used for measuring and comparing project initiatives. A number of items were on the table for discussion, including strategic and competitive importance, risks, as well as several economic measures. Much was discussed and looked at over the years but one measure stood steadfast, a basic expected ROI hurdle rate for every project.

Around us, our competitors built huge megaplex movie theaters on any open lot that they could find. We felt the competitive pressures but we could not make economic sense of many of our competitors moves – based on our scorecard. A few years later most of the larger competitors were in bankruptcy or went through painful mergers and acquisition. They had omitted the basics and invested without proper value calculations. It feels good to know now that we were on the right track but it was a agonizing period with lots of serious discussions and self doubt. In hindsight, we managed to get the basics right and thereby weathered an industry crisis!

Another important lesson from that period came from the executive team discussions. Organizational learning happens when you are willing to engage in an open dialog. The adoption of a scorecard or framework for decision-making becomes a vehicle for focusing these discussions and for framing the strategic direction.

Ultimately, an initiative is not just measured on its economic value but also through an understanding of the associated risks and how well it is aligned with the strategic direction.

Primer in Evaluation of Project Initiatives

To establish an evaluation of project initiatives you must determine how to collect or develop the required information and establish a framework for the evaluation itself. Obtaining this knowledge will take time and not all information may be available. Don't let this deter you; getting started with small steps is better than ignoring the issue.

We divide the evaluation of project initiatives into *three dimensions: strategic alignment, economic value, and risk assessment*. Together, these three dimensions form a cohesive view of the initiative. Start your framework by including each of these areas and consider the key indicators or measures in each area. To evaluate an initiative you must have quantifiable information, which means that you must be able to calculate the impact, if not in economic terms then in impact on a key performance indicator.

a. Strategic Alignment

The strategic alignment analysis determines the impact on key strategic performance indicators of the proposed project initiative. These are typically intangible and difficult to measure in monetary terms; however, a numeric Likert scale can be applied to all of these. Here are the key areas to consider, but you must decide the detailed performance indicators that make sense in your organization.

Strategic Fit – to what extent does this project advance your current strategic objectives?

Competitive Edge – to what extent does this project increase the market position, brand awareness, the service to customers, the ability to meet customer needs, meeting of market demands, or your share of the market?

External Mandate - to what extent does this project solve external mandates from government, industry, auditors, or corporate owners?

Organizational Development – to what extent does this project reinforce a desired culture, enhance employee relations, increase relevant knowledge, or enable the organization to function more effectively?

b. Economic Value

The economic value analysis determines whether the project initiative meets your thresholds for investments and provides quantifiable measurements to evaluate a project against other projects.

In order to evaluate the value of an initiative you must have quantifiable cost and benefit information. This is usually the first hurdle.

Cost information should be relatively straightforward but surprisingly many forget the total cost of ownership aspect of an investment. Items such as maintenance, renewal, and internal resource costs are often left out of the cost side.

Individual and subjective perspectives can greatly impact the benefit side since most initiatives have direct, indirect, and intangible benefits. Best and worst case scenario evaluation may enhance the development of a defensible stand.

Once the economic information is trustworthy, the evaluation can begin. The following financial measures all provide insight into the investment from different perspectives and can all be useful in your evaluation. What combination of measures you use may depend on your specific type of initiative and your level of sophistication.

Payback Period, or *Breakeven Period*, reflects the timeframe it takes for an initiative to yield a positive cumulative cash flow. It is easy to understand but gives a narrow perspective of the investment. Good to use if you are concerned with quick turnaround on the investment.

Return on Investment (ROI) provides the percentage return that an investment would generate, typically annualized but sometimes over a project period. When annualized, the ROI can readily be compared to that of other project initiatives. The widely used technique does not tell the magnitude of the investment and does not take into account the cash flow stream as well as the cost of capital. The ROI can be improved by

discounting the benefit and cost figures against the cost of capital – basically using NPV of benefit and cost in the calculation.

Net Present Value (NPV) gives you the present value of a future stream of cash flows by discounting the future cash flows against the cost of capital or any other preferred rate. It is a measure of the net benefit of an initiative in today's money. NPV is useful because it provides the magnitude of the value; however, not the magnitude of the investment.

Internal Rate of Return (IRR) takes into account the cash flow schedule of an initiative without discounting the cash flow. It provides a break-even rate of return at which the NPV is zero. In other words, if the cost of capital equals the IRR there is no economic value from the investment. An IRR rate level is often used as a hurdle rate for initiatives.

c. Risk Assessment

A risk is a current or future issue that may derail the project initiative. Few project initiatives take into account the relevant risks. Consequently many projects are either delayed or do not bring the expected value and strategic impact.

Risks can be measured based on their probability of occurrence and possible mitigation. The measurement of risks can be used as a stand alone quantitative measure or be translated into a discounted value that is used in the economic value analysis.

Resources may not be available in a timely manner or have the proper competency levels.

Timing requirements may cause a schedule that is unrealistic or the market may shift while a project is being delayed.

Legal risks and exposures may arise due to project topic matter, project delays or failures.

Vendors may not be able to deliver or support the project initiative.

Technology used in the project initiative may be unproven, non-compatible, or early in its lifecycle and therefore cause unforeseen issues.

Requirements may alter or “scope creep” may set in to change the project fundamentals.

Customers or internal users may not accept the product or solution, which reduces the benefits substantially.

Commitment amongst management and stakeholders may have been misinterpreted or alter during the project.

In Conclusion

By implementing a consistent process for evaluation of investment initiatives, you will be able to compare investments objectively and make well-informed decisions based on the entire need for capital and resources. Without this knowledge you are making gut decisions or guessing. Our advice: start the internal dialog, get the basics established, and then proceed and improve!

About the Author

As President of Kollner Group, Soren Eilertsen has helped numerous clients in different industries activate and align leadership teams around business results and innovation. Clients praise him for his ability to guide business leaders and teams to insights and new levels of success.

Soren works as a business consultant, educator and leadership coach specializing in strategy and organization development. He helps clients build effective leadership teams, create winning strategies, and obtain success with change initiatives.

Since establishing Kollner Group in 1999, Soren has helped shape the strategic directions and create results for numerous businesses and non-profits in both Europe and the United States. He has worked on world-class endeavors and been fortunate to engage with leaders in great organizations such as AECOM Design, American Suzuki, McKesson, Mission Critical Technologies, MK Sound, Motown Museum Project, Nordisk Film Biografer, Pacific Coast Producers, Pacific Theatres, Polar Air Cargo, Rand, System Simulations, UC Health System and Vulcan (Paul Allen).

Combining his education as a psychologist with years in corporate executive roles, Soren takes a unique integral approach that enables him to examine a business from the perspective of its internal leadership, systems, and culture as well as from the market-, business value-, and external customer perspectives.

Visit www.kollnergroupp.com to find out more about Soren Eilertsen and the Kollner Group.

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