



# KNOWBOT

## INNOVATION PORTFOLIO OPTIMIZATION

### *Dynamically Realign Strategy & Projects*

#### ABSTRACT

Analysing portfolios can be a tough job, especially when companies are operating in a largely global economy that is marred by uncertainty and complexity. Even trickier is to be in the driver's seat, taking decisions on what an innovation portfolio for an enterprise should comprise of. So, why do portfolios fail even though they were chosen having taken both business strategy and the vision of the enterprise into consideration? The answer, for most enterprises, is that they have not recognized the fact that changing market dynamics requires constant alignment and realignment of business strategy with existing projects and new initiatives. Successful portfolios are built with a high innovation quotient coupled with constant optimization of all initiatives across the end-to-end value chain, giving due consideration to existing projects while constantly evaluating the new ideas that are aligned with strategic business objectives.

This KnowBoT is targeted at a macro-level (corporate/enterprise wide) audience, where we will discuss why innovation is an integral part of portfolio management and how EFESO's innovation portfolio optimization process works to make the best choices for a successful portfolio. We also share some real-case innovation examples at our clients.



## Why Innovation in Portfolio Management?

The market has always been dynamic and unpredictable, requiring innovative strategic decisions to drive successful businesses. In these Covid-19 times, a truly unprecedented situation, there is a strong case for companies to develop expedient innovation strategies best suited to the new normal conditions; and to ensure company-wide implementation of strategically aligned projects and initiatives. Innovation portfolio management is a widely used tool that can help business leadership to translate their strategic business objectives and priorities into project-based innovation activities. Furthermore, it provides a framework to convert raw ideas into real investment opportunities, based on their risk profile. A good portfolio management system enables decision makers to select the feasible projects with relevant and balanced potential value based on strategic, economic or financial reasons that can provide a measurable impact on company growth and profitability, while also defining a proper process and clear responsibilities within the group.

## The Traditional Approach and Need to Innovate

The term *Portfolio* is certainly borrowed from financial books where a financial portfolio is built using decisions on investments in equity, debt or hybrid funds. Similarly, for any business organization investment in R&D or a New Product or a New Machine is an investment. Traditionally, portfolio management has been used as a tool for strategic planning and management of projects, programs and operations. Very often organizations introduce portfolio management to merely manage projects, but there is a lack of mechanism to continuously monitor and optimize the portfolio. The pipeline is usually filled with projects that might not be very valuable, but they seem to provide results. The issue is the absence of a measurement system that can clearly evaluate and confirm the correct projects to keep and the ones to be let go. Typically, it is the lack of governance in the value and flow in the pipeline, that makes innovation portfolio management a necessity for all enterprises.

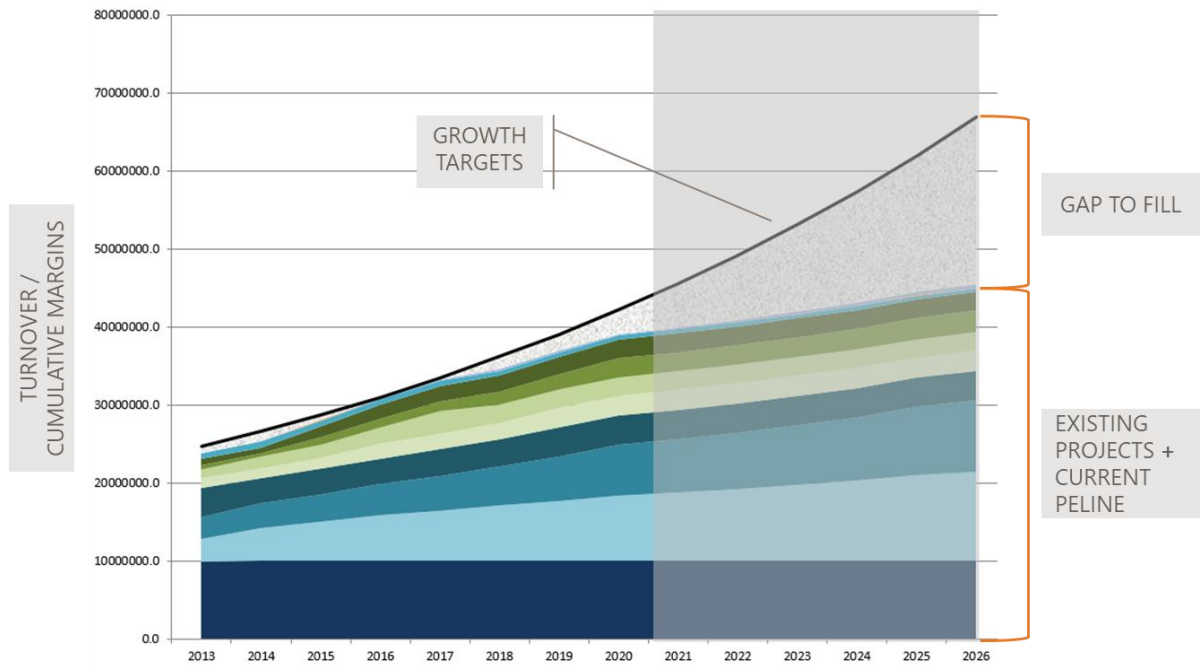
It is important to understand that portfolio management is done over the end-to-end value chain of any organization and it is not just limited to one business function. It can include services, products and even business models that can provide a competitive push to organizations whilst ensuring substantial return on investments on a consistent basis. This implies that strategy deployment and execution of projects with tangible results should be continuously integrated. Many businesses have struggled, not because their business strategy was flawed, but because they could not translate strategy into adequate projects integrated across the end-to-end value chain. Furthermore, the absence of due importance of innovation has often resulted in an imbalance of resource allocation, thereby making portfolios ineffective and missing their estimated potential.

## Assessing the Current Portfolio Sufficiency

At any given point in time, every organization has a set of projects or initiatives running that are based on strategic targets, market trends, customer needs and brand strategy. These four inputs are precisely the source of all the opportunities that are used as a basis to develop the roadmap for a local and global generation plan. But before understanding the steps of generating an innovation portfolio optimization, let us discuss an important KPI (key performance indicator) for Innovation, known as Portfolio Sufficiency.

Portfolio Sufficiency is the ratio of total projected turnover or cumulative project margins against the total growth targets planned for the company. Measuring Portfolio Sufficiency gives a clear picture of the impact of existing projects/pipelines and visualizes the quantum of additional projects to be added to meet future growth targets.

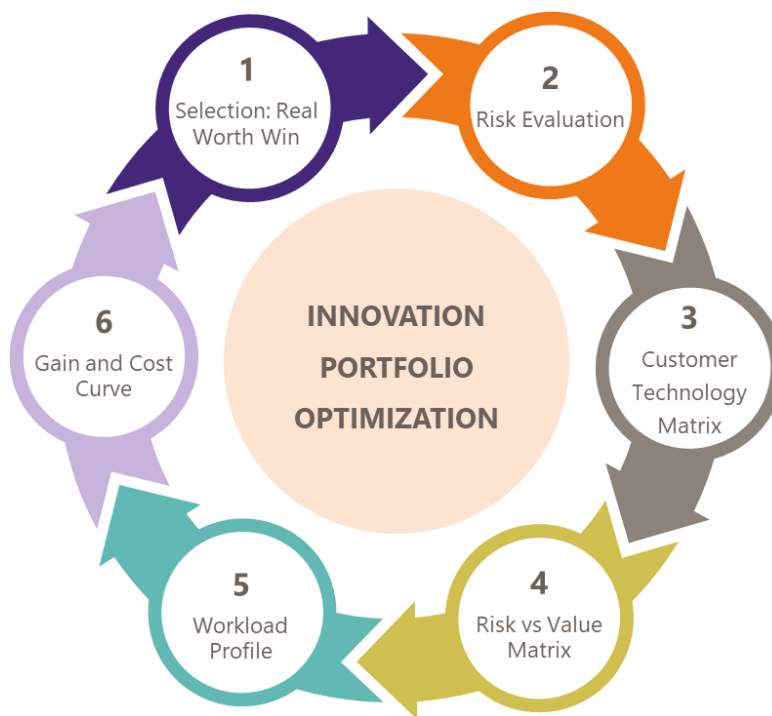
The chart below is an example of a current portfolio analysis of cumulative sales through all projects. It represents the projection of a company's turnover/ cumulative margins from existing products/services and the ones currently in the pipeline (the coloured area). The grey area is the shortfall, or gap, between current turnover and the growth targets, indicating the insufficiency in the portfolio and highlights the need to add more projects / initiatives for the coming years.



*The best way to start thinking about a portfolio is to visualise it in totality, so that it can be seen how the mix of projects fits the overall organizational needs.*

# The Process of Portfolio Optimization

We have discussed the importance of portfolio management and the need for integrating innovative thinking for portfolio optimization. The most fundamental approach to the portfolio management process is the alignment of business strategy with the product portfolio. EFESO has developed a comprehensive 6-step methodology to screen the best projects and create an Innovation Portfolio Optimization strategy for our clients.



**STEP-1 Real Worth Win:** It starts with putting on the table a comprehensive list of all ideas for projects and initiatives that could potentially be undertaken if the organization had infinite resources. We call them candidates because not all of them will be selected due to various reasons such as – inadequate market demand, too early or too late for the launch, high risk involved, expensive or lack of resources to execute such projects etc. A key trick here is not to talk about money at this stage, because often the *return on investment* argument kills an idea that has strong potential. Therefore, the progressive selection of a candidate is based on robustness of the idea above anything else.

We use a very reliable tool, called Real Worth Wins (RWW), where the ideas are tested for their robustness and potential pitfalls under three aspects:

- a) Real – Does the idea have a **real market**, where there is a need for the product and customers available to buy it and whether there is a **real product** that can be manufactured and potentially satisfy the need of the customer?
- b) Win – Can the **product be competitive** with clear advantages and whether that competitive advantage can be sustained in the long run and, if the **company is competitive** enough to support the product with adequate resources and appropriate management?
- c) Worth – Is there a suitable risk to reward ratio and whether the product launch makes strategic sense at this moment?

Every idea is scored against a set of questions under each category and based on the average score, a first project priority list is identified. For example, in the Covid-19 times, the idea of a beer company choosing to produce sanitizers from their plants might score big in RWW model.

*No idea is a bad idea! But it is important to choose only the ideas that are strategically aligned with business objectives.*

**STEP-2 Risk Evaluation:** The criteria for the chosen ideas are measured from the perspective of both market risk and technical risk, where each idea is scored on different parameters. Within **Market Risk**, we evaluate the customer's behavior and decision-making process, which in today's world is highly influenced by e-commerce, as people feel safer shopping from their mobile phones rather than visit a store in-person. This also includes evaluating the existing sales and distribution network to push the idea into the market. In addition, each idea is scored on the extent of relevance with the brand promise and current customer relationship, to ensure the new idea doesn't take away a positive brand image from consumers' mind. From the **Product Risk** perspective, foremost are current development capabilities and the technical competency to produce.

Take the example of a Shirt manufacturer evaluating the innovative idea of introducing a new shirt that can measure body temperature, heart rate and/or blood pressure. However upbeat the idea, it is critical to evaluate the required knowledge and science behind product development and the necessary sales and service functions.

The ideas that score low in both market and product risk become contenders for the portfolio and move to the next step. But we have also experienced 20% of ideas from the high-risk category moving ahead, simply because they are truly strategically aligned and might just give phenomenal returns.

**STEP-3 Customer-Technology Matrix:** The Customer–Technology (CT) matrix is based on measuring the innovation scale from the perspectives of **Customer Perception** and **Technology**. This step is critical for bringing in the element of innovation in portfolio and not just measure the success of projects based simply on management by objectives (MBO). It might be easy to successfully execute lots of projects, but true innovation portfolio management cannot be a reality without screening projects on the CT matrix. For example, a company like Apple only chooses projects that are a technological breakthrough and will provide the ultimate customer experience on innovation. However, not every company has the luxury of being able to allocate resources solely based on CT score, nevertheless, it makes a lot of sense to also evaluate the innovation dimension, as well as the RWW and Market/Product risk for ideas/projects and see the distribution of the portfolio with respect to business strategy. Another example could be Ferrari planning to invest in the idea of connected cars. Now if Ferrari chooses to invest in an innovation platform such as “connected cars” for a single model launch, then it is a very expensive and risky bet, but if Ferrari strategically decides to build it as a platform for all future models, then it makes a lot of sense.

**STEP-4 Risk vs Value Matrix:** Through the previous steps, we work to clean the list of candidates to a large extent. A further screening of ideas comes from the comparison of projects through financial and risk perspective. We use the concept of Zero-based prioritization, as promoted in a Gartner report, wherein we clear the complete pipeline of projects and start afresh by populating all the existing and shortlisted projects on the Risk (x-axis) vs Value generation (y-axis) Matrix. This matrix provides the opportunity to choose the priority projects starting from the left of the matrix, that is starting from low risk projects to high risk. It also gives us a quantification of the generation plans by consolidating expected profit growth from current products, ongoing projects and future opportunities.

Hence, a clear output of step-4 is the creation of a Quantified Project Roadmap, both of costs and benefits, based on priority, and it must include details of the strategic milestones (when); market trends and regulatory requirements (why); product platform, features, performances (what); technological capabilities (how); and partners, resources and infrastructure requirements (who).

**STEP-5 Workload Profile:** The next step is about managing the workload profile of the various departments who will come onboard for the execution of the project plan. The idea is to ensure that the portfolio generates a workload that is in sync with available capacity, and if it is not, then the management needs to work on the adjustment of capacity to honor the timelines in the roadmap.

**STEP-6 Cost and Gain Curve:** Finally, the portfolio is profiled based on the investment required for each project against the potential gains or benefits it is expected to provide in the coming quarters / years. The profile of costs and gains gives a final element to evaluate whether the portfolio is consistent with the business strategy and can fill the gap as per the portfolio sufficiency matrix, as discussed in the previous chapter.

So, these 6-steps close the loop for Innovation Portfolio Optimization and provide any enterprise with a clear roadmap for execution of projects aligned with business strategy. Typically, based on the industry it caters to, an enterprise can go back to the portfolio optimization loop every quarter (3-months) to test the robustness of existing projects and use the zero-based prioritization and rearrange the project roadmap, as necessary.

A basic condition in order to make this process effective and improve continuously (that in our experience is not always respected), is an existing attitude to consistently evaluate the performance of each product in terms of volumes and real margins (better if in a "full margin perspective"). In the absence of this "Lesson learning process", based on the comparison between the real results and the original Business Case (step 6) the organization cannot continuously refine the way it evaluates the potentiality of new projects, taking the risk to increase complexity (and therefore costs) due to unprofitable products.

*Any successful Innovation portfolio optimization requires dynamic realignment of strategy & projects.*

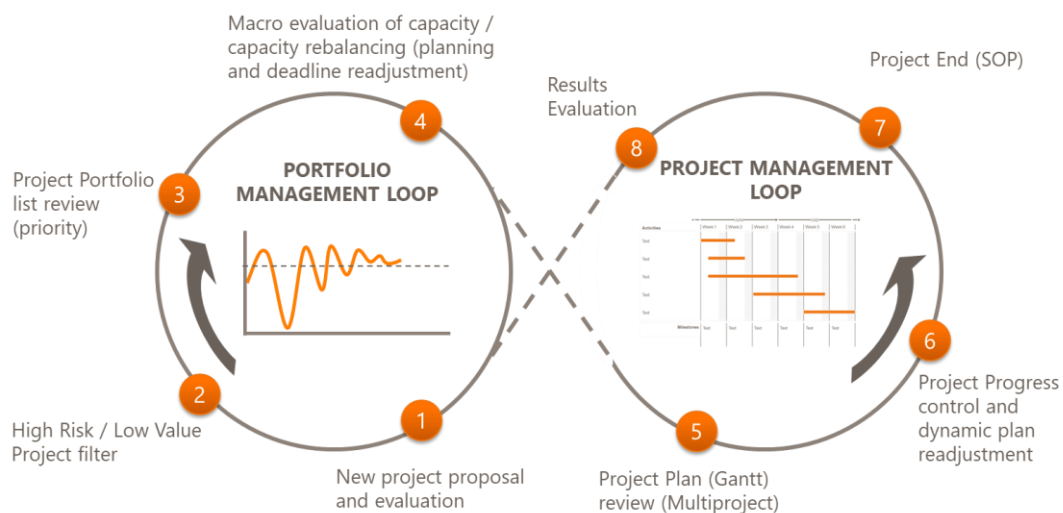


# Results and Key Takeaways

## Improve Business Development through more effective Portfolio Management

The client is one of the most competent fresh food packaging producers in Europe having a turnover of € 290 million and 13 establishments across Europe. The key challenges facing the client were business development performance and inconsistency between functions and sites. There was a need to refocus activities on high value business projects, duly considering financial implications. The ratio between effort and value delivered was high, as was time-to-market from Idea to Customer Delivery. On understanding the current condition, the EFESO team recognized some key opportunities for improvement and worked with the client to achieve the following results:

- Created an Infinite Loop comprising of the portfolio management loop which is connected to the project management loop. Portfolio management includes defining priorities and ensuring capacity rebalancing; while the project management reviews project plans, monitors progress and evaluates results on a continuous basis.
- Included a commercial and technical filter for existing projects to build a priority score on Value and Risk levels. This was critical to building capacity and workload rebalancing.
- Four drivers were defined for project selection and ranking. These were market risk drivers, technical risk, strategic fit and economic value drivers. Based on the weighted average score of each driver and sub-drivers, the Top Priority Projects were identified.



## Optimizing Product Development and Industrialization activities

The client is a global eyewear manufacturer producing over 14 million pairs of spectacles with nearly 1500 new variants every year and having a sales revenue of € 362 million. It has a presence in 127 countries with over 20 licensed and 6 house brands. The client approached EFESO for support in activities concerning product development optimization and industrialization to achieve an additional 9% growth in the new model category as compared to the previous year.

The EFESO team of experts evaluated the current situation and helped the client in mapping the industrialization processes and product development offices. The key efforts during our engagement included:

- ≡ Conducting Value Stream Mapping to identify and categorize wastes in the industrialization process.
- ≡ Analysing Value Added (VA) and Non-value added (NVA) activities and identifying improvement opportunities.
- ≡ Conducting KPI Analysis and propose an improvement implementation plan with estimation of potential savings.

Within two years, the client was able to increase productivity by nearly 50% and achieve a minimum of 20% lead time reduction in the industrialization phase.

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# KNOWBOT

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**KnowBoTs are ideas that will inspire and empower you to progress faster; by improving your results today, securing your results tomorrow.**

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