Gartner for Finance Leaders

3 Steps for CFOs to Improve Investment Prioritization

Investment prioritization is plagued by bias and unproductive detail, leading to suboptimal portfolios. CFOs should improve investment outcomes by separating prioritization from full business casing, forcing sharper executive trade-offs and extending upfront discipline to ongoing initiatives.

Overview

Key Findings

- CFOs often consider an unnecessary amount of business case detail to make prioritization decisions. This overloads decision-making bandwidth and anchors decisions to a wrong or incomplete set of criteria.
- Executives struggle to make clear trade-offs among the strategic priorities that drive investing decisions. This leads to a muddled priority set that spreads resourcing too thin across investing options.
- Finance teams focus too much investment prioritization effort on front-end processes (e.g., business case evaluation and stress-testing) and not enough on ongoing project performance management (e.g., assumption reevaluation and resource reallocation). This leads to high-potential initiatives underperforming due to a lack of resourcing and management attention.

Recommendations

To improve investment prioritization outcomes at their organization, CFOs should:

- Facilitate prioritization in alignment with strategic imperatives by separating full business casing from investment priority setting
- Introduce analytical techniques that force sharper trade-offs and cleaner prioritization outcomes in the investment evaluation and funding process
- Extend finance's upfront prioritization discipline to in-progress initiatives by instilling a structured cadence of investment review and reprioritization

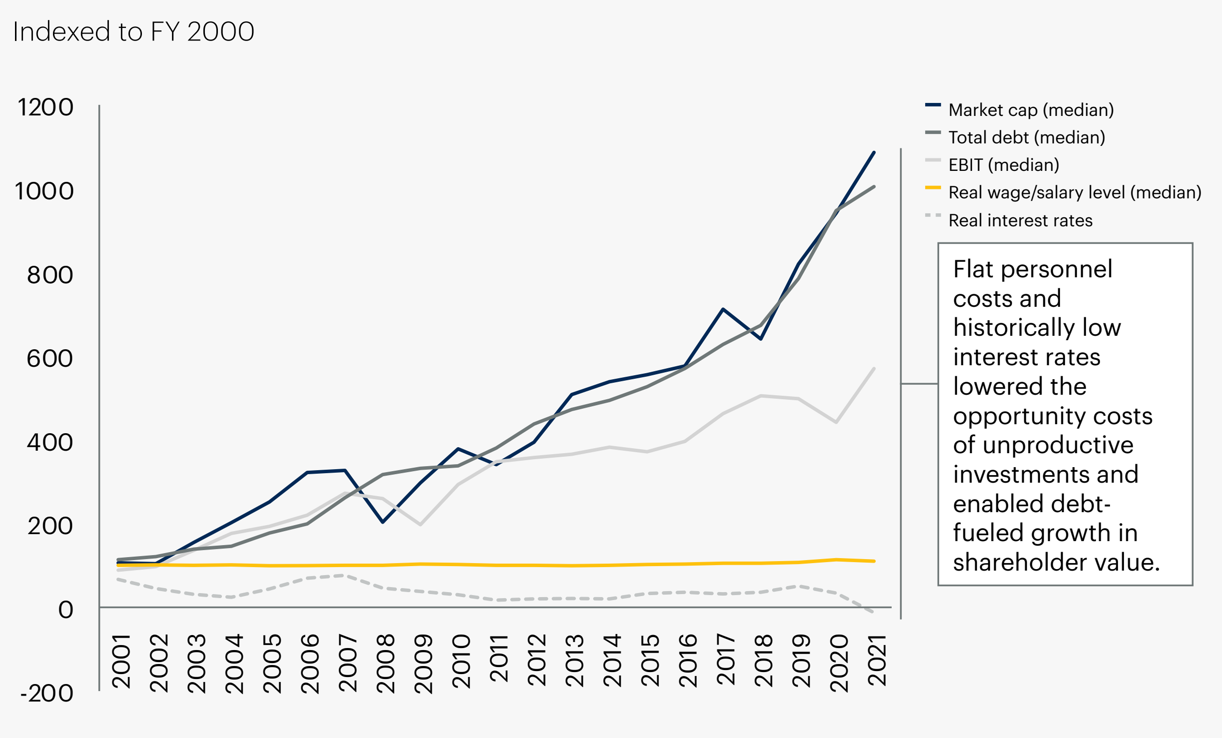
Strategic Planning Assumption

Through 2026, more than two-thirds of organizations will see the ROI of their digital investments underperform due to poor investment prioritization.

Introduction

For most of the postfinancial-crisis era, cheap debt and low labor costs allowed organizations to operate with flawed investment prioritization processes (see Figure 1). Low interest rates minimized the opportunity cost of bad investments, while flat nominal wages enabled organizations to readily staff up the next initiative without first taking a hard look at existing commitments.

Figure 1: Macroeconomic and nonfinancial firm trends, 2001-2021



n = firm-level trends for S&P 1200 companies; real wage/salary level from the usual median weekly earnings of wage and salary workers (annual average)
Source: Market cap, total debt, EBIT and real interest rates from S&P Capital IQ; real wage/salary level from "Weekly and Hourly Earnings From the Current Population Survey," U.S. Bureau of Labor Statistics
Source: Gartner

However, those underlying dynamics have changed significantly in the past 12 to 18 months, likely creating a “deadweight economy” scenario in the coming years. For most organizations, capital will be scarcer, interest rates and wages will be higher, and top-line demand will be muted. This creates outsize economic stakes for investment prioritization. Organizations that fail to prioritize their investments well will be burdened with unproductive assets, labor costs tied up on low-value projects and poor return on invested capital (ROIC) outcomes.

This scenario is complicated by insufficient existing tools for investment prioritization:

- Business cases have long been the primary tool for prioritizing investments, but the level of detail contained in business cases (e.g., full financial projections, detailed risk analysis) is usually unproductively granular for an enterprise prioritization discussion.
- The criteria that organizations rely on for making enterprise-level trade-offs are too rarely explicitly defined and weighted. This leads to investing outcomes in which capital is spread too thinly across available opportunities and critical bets are underresourced.
- Most of finance’s investment prioritization focus is devoted to ensuring the initial release of funding is allocated to the right initiatives, which underserves the enterprise’s need for ongoing reprioritization of existing, in-flight initiatives. As a result, enterprise portfolios too often become burdened with unproductive or strategically misaligned investments.

CFOs must learn how to advance past these traditional limitations and find new methodologies to confidently prioritize the right mix of investments for the enterprise. They must separate prioritization from full business casing, force sharper executive trade-offs and extend upfront discipline to ongoing initiatives.

Analysis

1 Evaluate investments against strategic priorities before building business cases

CFOs most often rely on business cases as the foundational element of an investment prioritization process. At a typical organization, an investment business case would include information such as:

- Detailed cost and benefit projections, including cost and revenue estimates across the project life cycle
- Risk analysis, including strategic, operating and financial risks, along with proposed mitigation strategies
- Measurable objectives and outcomes, including both financial and operating KPIs to track

However, the detailed level of project execution information in business cases makes them ill-suited for a discussion of strategic investing priorities across a set of alternatives. Recognizing this, CFOs should separate the investment prioritization process from a full business case review.

Effectively separating prioritization from business casing begins with a clear definition of the financial and nonfinancial criteria the organization will use to prioritize possible initiatives. These nonfinancial criteria are loosely and informally understood at most organizations. CFOs should make those criteria explicitly documented and understood across the executive team.

A Canadian financial technology firm took an instructive approach. The fintech company CFO helped a cross-functional group of C-suite leaders map the organization's mission statement into a clear set of criteria that define the types of initiatives the enterprise should pursue (see Figure 2). These criteria cover the financial, strategic, operational and human aspects of their investment portfolio. With these criteria defined, the executive team can make principled decisions about which investment options are most attractive and appropriate for the organization.

Figure 2: Strategic investing criteria

Reflect on the company's strategic goals and establish evaluation dimensions that portray a vision for the enterprise's ideal investment portfolio.

CEO CFO COO CIO CSMO CHRO

The firm will continually invest in the **people and technologies** that **drive cost efficiencies** and provide **superior payment solutions** to **customers.**

Evaluation dimensions

- **Growth strategy alignment:** Which growth strategy does the project directly support?
- **Mandatory/discretionary:** Is the project mandatory or discretionary?
- **Financial benefits:** Will the project generate a financial benefit?
- **Competitive position:** Will the project improve or defend our competitive position in the marketplace?
- **Threat urgency:** Will the project eliminate system availability and/or security threats?
- **Employee experience:** Will the project improve employee experience?
- **Likelihood for success:** What is the likelihood that the project will achieve the intended outcomes?

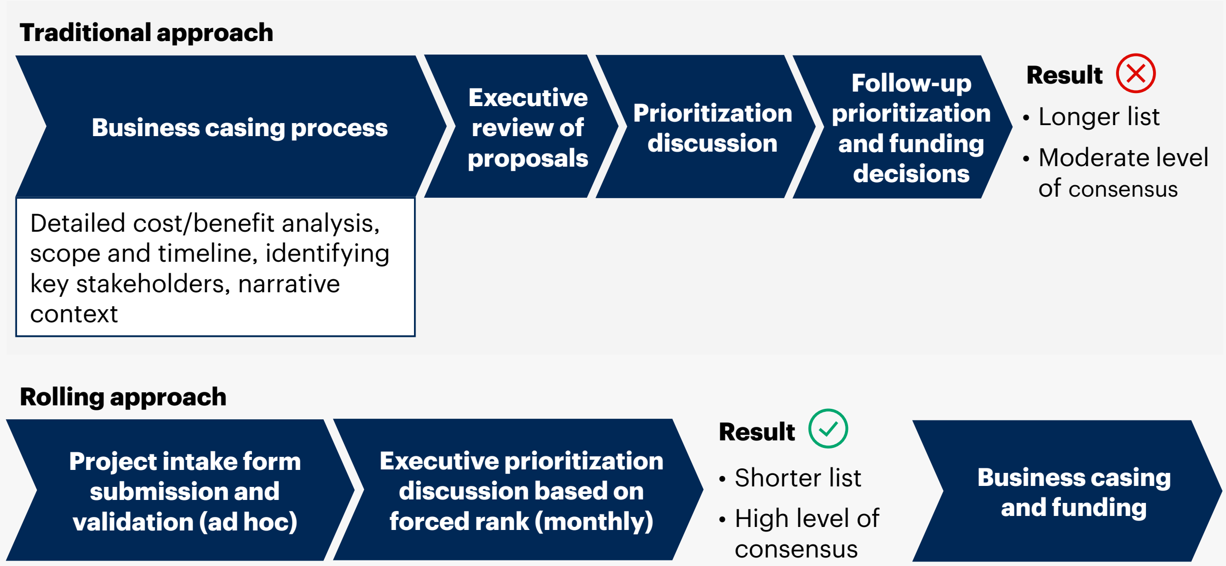
Source: Gartner

The firm now has regular (monthly) executive discussions of high-level details of emerging investment proposals, before the most promising candidates for investment undertake a full business casing process to specify execution details and funding requirements. This setup ensures prioritization discussions are:

- **At the right altitude —** Instead of using the false precision of detailed cash-flow estimates as the basis for prioritization, executives can consider a balanced set of priorities in a more principled fashion.
- **Strategically aligned —** Prioritization discussions in this context don't lose sight of the big picture by digressing into project details at the expense of strategic imperatives.
- **Efficient —** Executive time savings are substantial when the prioritization discussion is not weighed down by full business case analysis.

Figure 3 contrasts a traditional bottom-up prioritization process with a rolling executive-level prioritization process.

Figure 3: Contrasting approaches to investment prioritization



Source: Gartner

This resequencing of the capital allocation process enables a continuously updated focus on enterprise investment priorities.

2 Create evaluation processes that force clearer prioritization outcomes

To create a more focused list of enterprise investments, CFOs can adjust their quantitative methodologies to more deliberately lead to outcomes that support consensus around a shorter list of priorities.

Construct weightings that enable prioritization

The fintech company has also structured the math of capital allocation to facilitate focused outcomes. The CFO created a one-page prioritization scorecard that sponsors must populate for each investment. Rather than attesting to precise estimates, sponsors assign ranges to each category. Those ranges are then assigned to quantitative values that, critically, are not indexed sequentially (e.g., L/M/H = 1/2/3) but instead are artificially spread out and separated (e.g., L/M/H = 1/5/10). To create further separation, categories on the scorecard are assigned unequal weights, with more strategically critical priorities carrying a higher weight.

See Figure 4 for an example of this scorecard and scoring model.

Figure 4: Investment scoring to decluster projects

Illustrative

Project intake form

Evaluation dimension	Response options
Growth strategy alignment	Digital, etc.
Mandatory/ discretionary	Mandatory, etc.
Financial benefits Will the project generate a financial benefit?	• Significant financial benefit expected (NPV >$1,000,000) • Considerable financial benefit expected (NPV $500,000 to $999,999) • Moderate financial benefit expected (NPV $100,000 to $499,999) • Minimal to no financial benefit expected
Competitive position Will the project improve or defend our competitive position in the marketplace?	• Significant improvement • Moderate improvement • No improvement
Threat urgency	Imminent threat, etc.
Employee experience	Direct improvement, etc.
Likelihood for success	>90% confidence, etc.

Scoring model

Weight	Points	Multiple
15	Up to 10	Up to 150
25	Up to 10	Up to 250
15	10	150
	7	105
	5	75
	0	-
15	10	150
	5	75
	0	-
10	Up to 10	Up to 100
10	Up to 10	Up to 100
Up to 100%		
Project score		Up to 900

The points available for response options in each dimension have a difference greater than one to increase the spread between projects.

To further increase spread, multiply the "Likelihood for success" percentage by the sum of all multiples.

Source: Gartner

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This “forced separation” of the quantitative output does not fundamentally change the order of investment priorities, but it does more clearly separate investments from each other. This lets CFOs define tiers of investment attractiveness that are more obvious to the executives making decisions than a tightly grouped set of internal rates of return (IRRs) would be. This then makes it easier to leave behind less attractive investments and organize a shorter list of highly attractive opportunities at the top end of the scale.

A more sophisticated mathematical trick CFOs can employ is an analytic hierarchy process (AHP).

An AHP is a mathematical tool available in end-user-friendly formats in a variety of software packages but also executable in basic spreadsheet programs such as Excel. AHPs are highly effective prioritization tools since humans are far more effective at communicating their true preferences through the types of pairwise comparisons used by an AHP than through a multifactor assessment across categories.

Using an AHP, CFOs don’t have to solve the question of how much capital should flow to each set of enterprise strategic priorities (e.g., new product development, health and safety, efficiency, customer experience) in a top-down fashion. Instead, they can have the executive team step back and assess these priorities against each other one at a time: How much more important is investment in Category A versus Category B? How about Category B versus Category C?

The AHP takes these individual assessments and consolidates them into the unified set of quantitative judgments that are logically implied by those individual answers. The result is almost always a crisper, more widely separated set of priorities than humans would ever come to by using their collective judgment on a long list of priorities, where spreading available capital too thinly is the default.

Figure 5 illustrates how AHP usage creates a unified set of priorities with clear separation and delineation. Individual pairwise judgments feed a matrix of one-to-one comparison results that then feeds an aggregate list of weighted priorities.

Figure 5: Analytical hierarchy process (AHP) usage in investment priority setting

Illustrative

	Market penetration	Customer experience	Product innovation
Market penetration			
Customer experience	Customer experience 3/5		
Product innovation	Market penetration 2/5	Customer experience 4/5	
Operational excellence	Market penetration 3/5	Customer experience 5/5	Product innovation 1/5

Investment priority	Value multiplier
Customer experience	10x
Market penetration	7x
Product innovation	5x
Operational excellence	3x
Risk management and mitigation	2x
Employee culture	1x

Participants assess how much more important one pillar is compared to the other on a 5-point scale.

The AHP translates those pairwise comparisons into an aggregated list of relative weights.

Source: Gartner

The AHP's output can be used to set guardrails around how much relative funding (and, correspondingly, organizational time and attention) each category of investment should get. CFOs can then use individual business casing to populate the specific initiatives in each category within the top-down constraints set by this prioritization exercise.

Unpack operating risks

Even in instances where CFOs must rely on traditional financial criteria to prioritize between competing investments, they can mitigate the prioritization challenges these criteria create. Investments with radically different underlying profiles can appear similar, and therefore hard to distinguish between, when analyzed through standard discount rates applied to cash-flow projections. To better prioritize their investment portfolio, CFOs should ensure financial evaluation reflects the true operating risk profile of an investment.

One productive way to better prioritize based on an individual investment's operating risk profile is to create an operating risk score for each investment (see Figure 6).

Figure 6: Investment operating risk scorecard

Illustrative

	3	2	1	0	Score
Market	New emerging market	New mature market	Reentering previous market	No new market	**3**
Product	New-to-company product technology	Product technology unproven at scale	Repurposing of existing product tech	Minimal changes to existing product	**2**
Size and scope	Much larger and more complex than usual	Somewhat larger and more complex than usual	About as large and complex as usual	Smaller and less complex than usual	**0**
Track record	No company experience in this area	Minimal company experience	Some company experience	Company is highly experienced with this type of investment	**2**
Volatility	Highly susceptible to moves in market	Moderately affected by moves in market	Minimally affected by moves in market	Not affected by moves in market	**1**
Skills	Reliant primarily on new-to-company skills	Reliant primarily on existing but scarce skills	Reliant primarily on existing and available skill sets	Not significantly talent-dependent	**3**
				Risk Score	**11**

Source: Gartner

This type of scorecarding helps differentiate between investments that might have similar high-level cost-benefit stories but considerably different operating characteristics. CFOs can use this evaluation to prioritize the right mix of investments across dimensions such as:

- How large or small the undertaking is
- How new or well-understood the market and/or technology is
- How unknown or predictable the operating results are expected to be

3 Extend prioritization discipline to in-flight and in-progress initiatives

High-performing growth organizations are just as prone to initially funding an investment that ends up missing its business case as the average organization is. What separates high-performing companies is extending finance's prioritization focus to "in-flight" investments that are already underway. This shift in focus is successful because of:

- The flood of useful information about investment performance that materializes after the investment has been funded
- Shifts in customer or market dynamics that change or erode the value drivers of an investment
- An evolving organizational strategy that can make initiatives (even on-time, on-budget ones) unfit for continued investment due to strategic misalignment

Thus, CFOs must balance the necessary discipline on upfront investment evaluation with an ongoing focus on continuing in-flight investments. This ongoing review must be more than a cursory check-in on whether a given investment is on schedule and on budget. High-performing CFOs recognize the need to actively adjust investment resourcing on an ongoing basis: Sometimes this means stepping away from an investment, and sometimes it means increasing funding to take advantage of an opportunity.

CFOs should facilitate this ongoing resource migration through an executive portfolio review committee. This committee should consist of senior finance, operating and IT leadership, and it could potentially include supply chain, R&D, HR and other representation depending on the nature of the investments under review. Align the cadence of review to the underlying pace of change in the business itself; common cadences include monthly, quarterly and annually on a "7/5" basis (i.e., in month seven of the plan year).

The mission of this group, and the agenda of each meeting, has two parts:

1. Identify resources that can be swept from existing and planned investments. Existing business investments may have their ongoing resource needs deprioritized for a few different reasons:
   - The investment is proceeding more slowly than planned and therefore will not require funding on the timeline forecast.
   - The investment should be paused or discontinued for performance reasons.
   - The investment is no longer aligned to the organization's strategy.
2. Redirect resources to high-priority initiatives. The most important outcome from this type of committee is to ensure high-potential and strategically critical initiatives receive the resourcing needed to deliver full value to the enterprise. At a minimum, this resourcing would consist of newly available funds. In more progressive organizations, particularly people-intensive organizations like professional services firms, CFOs lead a conversation about reassigning headcount from underperforming initiatives to high-potential initiatives.

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