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Making Investments Count: Three Capital Spending Challenges

Executive Overview

Although the global economic environment is on the mend, companies are cautious. And rightly so, given the erratic nature of today's international markets. Enterprises in asset-intensive process industries – like utilities, oil, gas, chemicals and mining – are in a precarious position due in part to the massive amounts of capital required to sustain and grow their businesses. For that reason, it's imperative that leaders in these industries ensure their investments are driving enterprise value, reducing costs and improving operational efficiency. This whitepaper will provide an overview of the capital investment challenges facing companies in these industries, explain how enterprise project portfolio management solutions can help, and delve into the specific ways companies can improve their key capital investment processes.

Introduction

Constrained capital markets are putting added pressure on the allocation of capital. Even if the source is internal funding the pressure is the same: greater rigor and increased thresholds for allocating project funding. The expectation is that those tasked with managing the investment will plan, model, prioritize and execute projects within a framework that drives alignment with corporate strategy while maximizing the return on investment (ROI).

As an example, utilities are expected to see a 31 percent increase in capital spending (through 2013) to meet the long-term global hunger for power, according to McKinsey and Company¹. On the surface this is good news: investment to meet a growing demand. However, the environment in which this is occurring presents challenges. In addition to increased customer demand and constrained access to capital, they also face an aging infrastructure, competition for raw materials and skilled talent to build and upgrade their

¹ Thomas Hundertmark, André Olinto do Valle Silva & Jeff A. Shulman, "Managing Capital Projects for Competitive Advantage," *McKinsey Quarterly*, June, 2008.

facilities. Given the sheer magnitude and long-term impact of these investment commitments there needs to be a balancing of long-term capital investments against short-term market dynamics.

Executives and leaders in asset-intensive process industries need greater rigor for selecting and carrying out capital projects throughout their lifecycle by applying more formal processes and achieving heightened visibility, accountability and financial results both short and long-term.

The Challenge

Optimizing and increasing the efficient use of capital is one of the biggest challenges facing leaders in these industries. Many companies continue to struggle to dynamically manage their long-range plans, including realistic project cost estimates adjusted for inflation, with their short-term needs. However, only focusing on the financial aspects would be short-sighted and miss the parallel issue of managing resource supply and demand.

Companies are continuing to strive to institute the equivalent of a “Resource Center of Excellence” to ensure capacity needs are met now and in the future, utilization is optimized and most importantly, work is completed. The twin pillars of finance and resource must be firmly in place to successfully execute on short and long-range plans. However, these two pillars aren’t complete without a third element – strategic planning.

What makes these challenges so pervasive is that many companies approach capital projects as isolated, individually tailored undertakings and fail to look at all of their projects as part of an integrated long-range plan or portfolio. This approach limits desperately needed collaboration between various groups to effectively utilize scarce resources and precious capital. One of the main contributors to this approach is the lack of a repeatable governance or decision-making process and consistent evaluation metrics in which to prioritize and select the optimal mix of portfolios. Another contributor that fosters reliance on this isolationist approach is that the information required to bring teams together is trapped in fragmented and siloed systems.

Since funding and resources are typically constrained and the bets placed on long-term capital investments huge, companies need to start the process with prioritizing their existing investments to ensure that those with the highest potential or those that are mandated by regulatory or safety requirements are balanced against these constraints. For long-range planning this prioritization needs to be conducted not only based on capital constraints and various escalation factors, but also anticipated shifts in demand, regulatory changes and skills shortages. With existing initiatives prioritized the proposed initiatives need to be included to get a complete understanding of the portfolio and requests that require funding. The process whereby initiative funding is granted often contains multiple decision points or approvals based on the amount of funds being requested. Securing approvals is frequently laborious and fragmented, creating a serious time drain that can delay finalizing the capital budgeting process. All along this approval process, the initiative funding request status may be changed to move forward with the initiatives, postpone them, or cancel them altogether. These are difficult decisions that require a holistic view of all the initiatives and the relevant, summarized and consistent evaluation criteria of many variables. It is also essential that this happens in a timely fashion to deal with the dynamics of the marketplace.

All these challenges – often considered “business as usual” by many in the industry – are suddenly thrust under the microscope when project funding begins to dry up. As a result we see

three main areas of focus that can improve the capital investment process:

1. Balancing short and long-term planning
2. Integrating siloed planning groups
3. Aligning planning with execution

By focusing on these areas we believe companies can more effectively optimize project portfolio management and ensure that capital expenditures drive return on investment and shareholder value. Through a more rigorous approach they can not only assess, prioritize and select the best projects but also have insight into key metrics like financial forecasting and cash flow.

The Solution

A portfolio management solution enables companies to address the industry's unique challenges to optimally assess, prioritize and select – and ultimately execute – the right capital investments and projects. Portfolio management solutions help an organization institute and follow repeatable processes to manage the lifecycle of the capital investment from inception and operation, to retirement. Making sound and objective decisions also requires that the performance of the portfolios of investments and their ability to continuously provide value is compared fairly and consistently. It's interesting to note that in a recent project and portfolio management survey by the Economist Intelligence Unit (EIU) less than one-half of respondents measure whether their projects had a quantifiable return on investment.² Ultimately, portfolio management solutions can give companies the edge – strategically, financially and operationally – they need to succeed.

Balancing Short and Long-Term Planning

The short and long-term perspective of the capital investment portfolio enabled by portfolio management brings the visibility organizations need to effectively manage their current and future plans. Portfolio management solutions summarize the relevant data to make effective decisions between potential capital investments, investments in operation and those nearing retirement. Often making the best decisions demands portfolio data analysis from many facets that take into consideration long time horizons, resource constraints, regulatory requirements and multiple dependencies. And, since funds and resources are limited, trade-offs are a key part of the decision making process. For example, since oil and gas rigs still “can fetch more than \$600,000 a day to rent” and need to be reserved well in advance of their need, companies must have a high-

² “Closing the Gap: The Link between Project Management Excellence and Long-Term Success,” *The Economist Intelligence Unit*, December, 2009.

level of confidence in their project portfolio in order to avoid costly and time-consuming mistakes.³

Portfolio management enables this multi-dimensional analysis and what-if scenario planning with the right level of visibility to justify these crucial decisions. Having the justification is the first part of the battle, getting the buy-in from the rest of the organization wins the war. A portfolio management solution provides objective short and long-term evidence to back-up these decisions and enables the right people within the organization to be alerted when their input is required. It all comes down to a matter of perspective – visual perspective, analytic perspective and objective perspective – to enable smarter investment decisions, more efficient use of resources and faster time to value while meeting safety and regulatory requirements.

Integrating Siloed Planning Groups

With a portfolio management solution, leaders throughout the organization can identify where efficiencies could be gained by identifying synergies between investments across the organization that highlight how resources can be deployed to get more work accomplished faster. For example, skill sets available for similar projects could be deployed at the same time for site selection so the permitting process can be streamlined.

This visibility across the entire portfolio further enables more efficient use of resources reducing the strain on the lopsided resource supply-demand equation. What's more, when teams are able to collaborate and transparently discuss progress, they streamline processes, improve accountability and are able to make decisions more quickly and accurately. This also holds true throughout the business. Operations leaders, for example, have a set of criteria and goals for an investment, while financial executives have their own set of metrics that will indicate success. Bringing these metrics together provides a more complete and transparent picture of the portfolios and makes the planning process more accurate and robust.

Once again, visibility across the portfolio – from different functional groups and teams – and the ability to measure the various projects against each other helps executives easily find efficiencies which lead to cost and time savings.

Aligning Planning with Execution

A portfolio management solution breaks down the walls between those tasked with planning capital projects and those executing the projects. The governance process emphasizes a broader, strategic vision of the portfolio and its iterative nature keeps teams collaborating through the

³Bloomberg.com,

<http://www.bloomberg.com/apps/news?pid=20601109&sid=arOVNMNWnSJA&refer=home>.

planning and execution phases. The key to meeting or exceeding organizational goals is to instill a mindset in the organization that the planning process is dynamic and requires a continuous assessment of how the existing investments are not only performing, but supporting strategic goals. If cataclysmic changes in the marketplace occur, the strategic objectives of the business will likely need to change and can create a misalignment between the existing investments and the new goals. Hard decisions about continuing or discontinuing funding of investments will ensue. These decisions must be communicated throughout the organization and will impact those teams responsible for delivering on the investments.

Portfolio management solutions keep everyone aligned even if the changes are difficult. The objectivity these solutions deliver makes it hard to argue with the facts. Linking the planning and execution processes allows for investment adjustments that enable the effective management of change as the execution information identifies variances against the plan. In addition, regular progress evaluations, simplified by summarizing detailed project and resource management data for portfolio analysis, provide a vehicle of communication to mitigate the consequences of unforeseen change. Since one of the pillars of portfolio management is its ability to bring the right information together using a “single version of the truth”, all the data resides in one repository and everyone works off the same information. No longer do project teams have to waste time ensuring that the information they’re working with is accurate and timely.

Success Story

Since the mid-1950s a large water utility has provided water to a major metropolitan area in the western United States. They helped construct the city’s water distribution system and currently provide water to more than one million people.

The company faced a number of challenges, including

- improving the project management communication processes and eliminating information silos (including duplicated efforts)
- improving fiscal accountability to customers
- reducing project cycle times
- generating program-level metrics
- achieving repeatable project success

By partnering with this company, Oracle helped them implement a real-time portfolio management capability for all employees that is easily navigable (via the web) and integrated with both Oracle Primavera solutions and Oracle Financials. The results were substantial and included the ability to:

- accelerate projects, including nine new projects in support of a capital improvement expansion program of more than US\$2 billion – while remaining under budget by 14%

- realize savings in committed resource costs and enabled the district to be more accountable to 306,000 customers
- reduce project cycle times by enabling project managers and executives to view project status, schedules, costs and documents all in one place
- execute faster, while enhancing transparency across the project eco-system

Conclusion

The EIU survey also uncovered that only 6% of companies said their projects came in on time and on budget all of the time.⁴ Clearly, with Oracle's Primavera project portfolio management solutions, asset intensive process industries will be in a better position to successfully plan and execute their capital investments because a focus on the three areas – balancing short and long-term planning, integrating siloed planning groups, aligning planning with execution – will better enable leaders to make smarter, more timely decisions while reducing project portfolio costs and speeding time to completion, all with one end in mind – delivering enterprise value.

⁴ "Closing the Gap: The Link between Project Management Excellence and Long-Term Success," *The Economist Intelligence Unit*, December, 2009.



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