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Agile funding: An investment management approach to funding outcomes

Truly performance-driven organizations do more than adopt agile ways of working; they take an agile approach to the enterprise funding process to allocate talent and capital toward the right outcomes.

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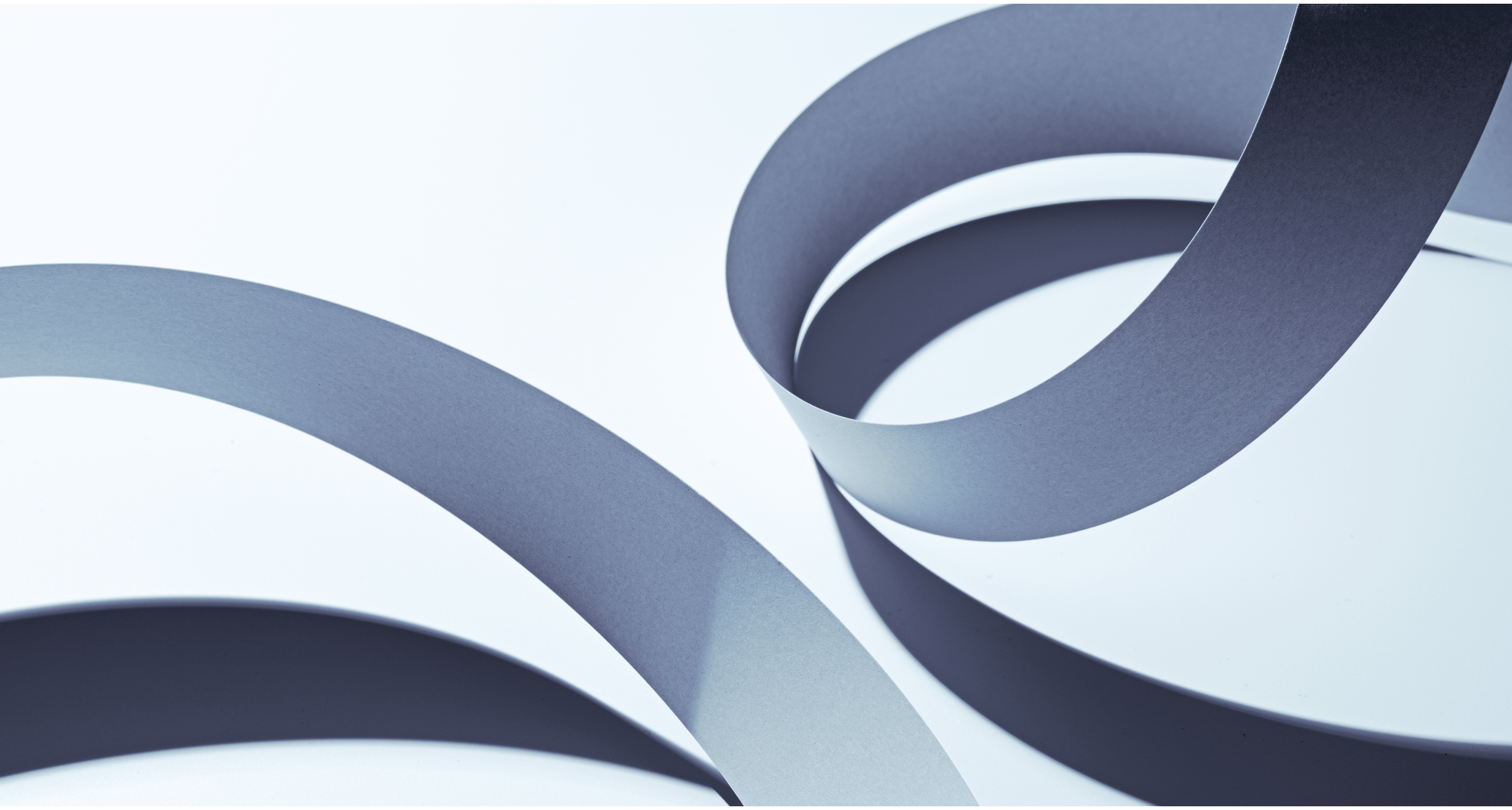

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Over the past decade, many organizations have shifted to an agile mode of delivery, fueled by the need to increase their "metabolic rate" and build new ways of working to allow teams to continuously test, learn, and adapt.[1] They've reorganized people and work, with a focus on agile portfolios that align with profit-and-loss (P&L) or business line priorities—also known as tribes, domains, or value streams. These agile portfolios include user journeys, products and shared platforms, and embedded agile roles (such as product owner or agile coach). The benefits are evident: persistent, mission-based and cross-functional agile portfolios can respond more quickly and precisely to market shocks and changing customer needs—not only during crisis situations but also systematically.

Yet as these agile portfolios reach scale, C-suite executives struggle to align them with enterprise goals and continually adjust investments as those goals evolve. What they need—and what only a small handful of companies have truly applied—is an approach akin to that commonly used by investment companies:

— The executive committee sets top-of-the-house goals and assigns a fixed budget to each agile portfolio (at least for the coming year) based on aligned expectations for the outcomes that each portfolio will deliver to meet these goals.

— Agile portfolios then direct the prioritization and execution of work by the agile teams to maximize outcome delivery while operating within the allotted budget.

— The portfolio lead continually measures outcomes delivered against the target—including any P&L impact—and actively drives decisions about how to deploy available capacity toward the highest-value work.

— The executive committee maintains the flexibility to assess and reallocate the budget—for example, if enterprise goals shift or certain portfolios are not delivering expected outcomes.

Supporting agile delivery in this way calls for fundamental changes in finance and strategy that can seem daunting, especially to large legacy incumbents that have rigorous, long-standing financial processes embedded in their organizational DNA. However, if agile transformation is an intentional journey for organizations committed to fundamentally changing their ways of working, then it is time to take the next step.

This article describes why traditional funding inhibits, rather than promotes, agility and explains the four shifts companies should consider making to effectively fund outcomes.

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[1] "The journey to agile: How companies can become faster, more productive, and more responsive," McKinsey, October 5, 2020.

Traditional funding models are at odds with agile principles

Traditionally, funding has been an important vehicle for C-suite leaders to exercise control and ensure alignment on enterprise goals. However, traditional funding contradicts the fundamental principles of agility in several respects:

— It favors large-scale initiatives that are extremely well detailed at inception and then held constant. Agile, in contrast, emphasizes continuous discovery and testing of outcomes through minimal viable products (MVPs), with teams empowered to adjust their approach based on market feedback.

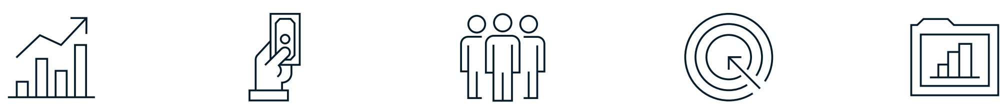
— It does not proactively reallocate resources based on interim outcomes. Agile, on the other hand, is anchored in the ability to quickly pivot resources to the highest priority as needed.

— It often assesses financial and operational outcomes post-mortem, once the project is done and the budget consumed. Agile uses these outcomes as a yardstick to test the efficacy and impact of work as it is being delivered.

To create truly agile enterprises, corporate leaders must overhaul traditional funding principles—the next major step in the agile journey for the large incumbents across industries that have piloted agile in the past few years. According to McKinsey analysis,[2] organizations leveraging advanced agile practices, including agile funding, were able to react to changes driven by the COVID-19 pandemic up to twice as fast as the national average (Exhibit 1).

Exhibit 1

Agile funding and planning allows enterprises to achieve flexibility and speed while maintaining strong alignment.



Ensure **ongoing visibility and alignment** into the organization's financial performance	**Control** the organization's **expenses**	**Maintain financial accountability** across the organization	Improve the ongoing **delivery of business value**	Ensure that **investments** are made in line with **shifting priorities**

60+%	**20–30%**	**100%**
reduction in time required for annual budgeting (from 6 months to 2 months)	of priorities are refreshed every quarter by pausing or stopping low-value work	visible linkage between enterprise strategy and work done by teams

Source: McKinsey analysis

[2] Gregor Jost, Deepak Mahadevan, David Pralong, and Marcus Sieberer, "How COVID-19 is redefining the next-normal operating model," *McKinsey Quarterly*, December 10, 2020.

Four shifts support the switch to agile funding

By focusing on making four shifts, organizations can transition to a funding approach that supports their agile aspirations and maintains enterprise-wide alignment with strategic goals.

From funding transitory projects to funding persistent portfolios

Traditionally, during the annual "budget season," funding and planning committees spend up to six or eight months determining the size and scope of projects to fund in the next year, with a high degree of precision regarding their business cases. Projects then kick off throughout the year, often with little prioritization. Projects that start later in the year may even need to go back to funding and planning committees for reapproval, especially if the budgeted resources are not naturally available due to overruns or scope changes with projects already in flight. Many of these projects never get under way and are carried over to the next year. In short, how the year starts and how the year wraps up are markedly different, despite the extensive planning effort invested up front. As an example, prior to implementing agile funding, one North American financial institution realized that up to 50 percent of its funding was getting absorbed into unplanned or lower-priority work, leading to a failure to launch many of the top planned priorities.

By contrast, agile organizations shift from funding projects to funding persistent portfolios, each with a discrete mission (Exhibit 2). These portfolios define and strictly prioritize their target outcomes for the year—sometimes referred to as objectives and key results (OKRs)—and determine the fixed number of agile teams needed to achieve the intended outcomes. Each agile team is also typically a fixed-size unit comprising six to nine dedicated individuals with cross-functional skills from business, IT, and any other supporting function needed to complete the mission.

The funding sought by each portfolio is a function of the number of teams they need and any nonlabor expense estimates, such as licensing costs. Once approved, the team capacity is assumed to be fixed—at least for the fiscal year—and the funding envelope is allocated to the portfolio as a combination of capital expenditures and operational expenditures. The portfolios kick off work immediately, with their allocated teams starting on a backlog prioritized to deliver the top-priority outcomes per their target timelines.

Allocating funding to these portfolios with strictly prioritized outcomes has allowed the financial institution mentioned earlier to deliver on more than 80 percent of the top enterprise priorities outlined at the start of the year. It has also brought a higher degree of predictability to business planning and change execution as a result.

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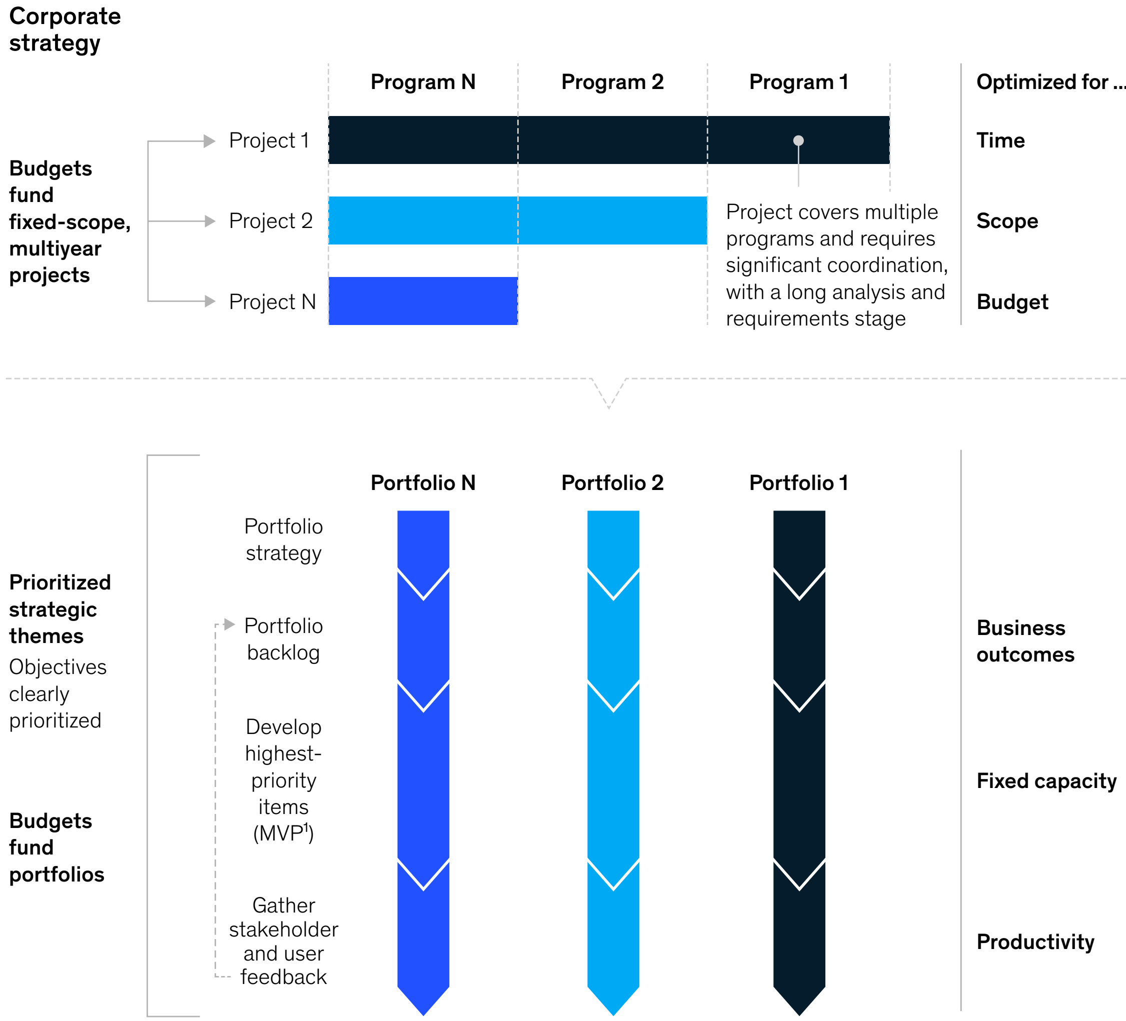
Exhibit 2

Agile funding and planning requires a shift from one-off projects to persistent portfolios.



[1]Minimum viable product.
Source: McKinsey analysis

From funding long-range efforts to funding iterative outcomes
Traditionally, funds are allocated to projects for their entire duration based on their intended outcomes. As a result, the fund distribution across projects is anchored in the effort needed to deliver on each, rather than on their ability to demonstrate early value. Thus, organizations often find that massive investments can become locked in to low-performing projects while mission-critical needs remain queued up and awaiting execution.

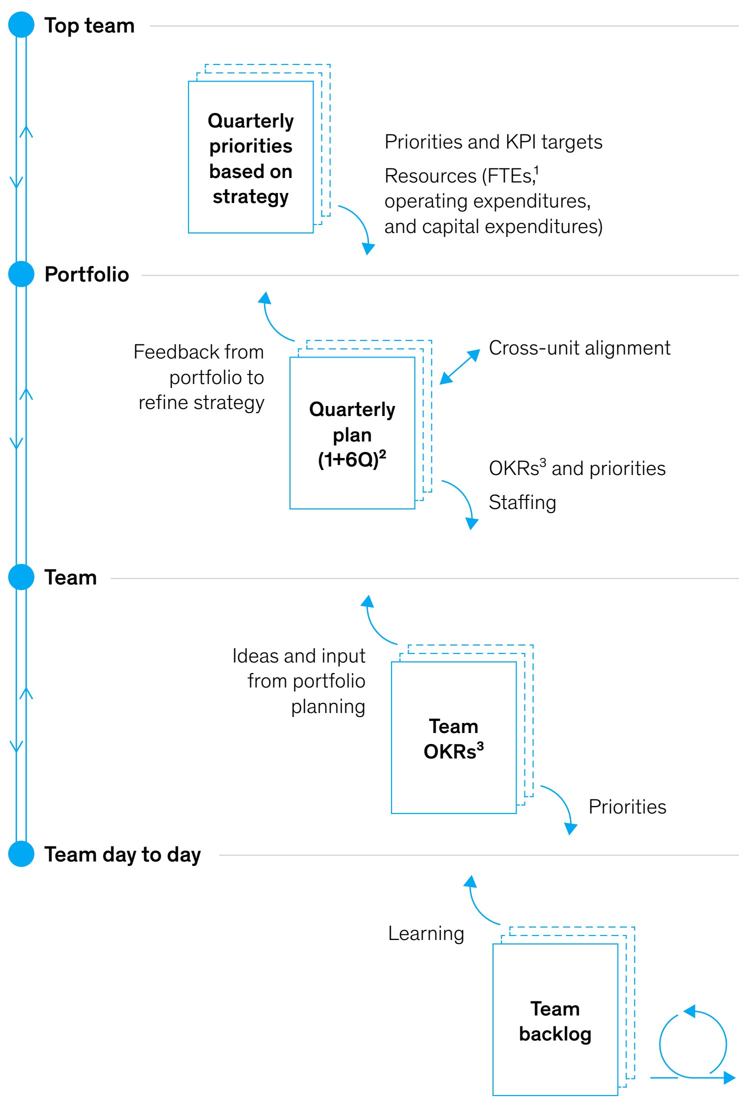
A situation such as this may give the appearance that C-suite leaders are not paying attention to project outcomes, but this is untrue. In fact, project leaders take pains to estimate ROI and internal rates of return when submitting their business cases. Instead, such queues occur because funding gets committed based on long-term outcomes with no way for executives to assess how these projects are performing along the way. OKRs play a key role in shifting investment decision making toward measurable outcomes.

C-suite leaders set enterprise goals or OKRs annually in close collaboration with portfolio leaders and use them as a vehicle to drive strategic alignment on priorities across the company. Portfolio leaders, in turn, work with product owners to create portfolio-level OKRs that guide work for the next 90 days and that eventually become enterprise OKRs (Exhibit 3). Multiple portfolios often work together to achieve enterprise OKRs, which helps to break silos and allows colleagues to collaborate beyond their specific portfolio. A product owner from a leading telecom company based in Asia–Pacific endorsed this approach, saying, “In my 25 years at this company, I have never seen strategy this close and context this clearly.”

OKRs not only provide a tight feedback loop between C-suite leaders and the agile teams driving

Exhibit 3

Companies are using quarterly business reviews as an engine to drive dynamic funding and talent allocation.



Strategy at the company level is defined 3–5 years ahead in an adaptive way. Every 90 days, the top team reviews the strategy, refined company priorities, and OKRs[3] and reallocates funding and talent across portfolios based on customer feedback, the market situation, and learnings.

Quarterly business reviews (QBRs) are a company-wide ceremony in which portfolio leaders cocreate the priorities and OKRs[3] for the next 90 days based on company strategy with other portfolio leaders and product owners or managers from their portfolio.

Talent and funding are dynamically reallocated between portfolios based on shifting priorities and learnings.

Team OKRs[3] are cocreated by the product owners of each team and their team members. Product owners and team members, being the closest to the customers, relay feedback to the portfolio leaders and top team if any changes need to be made to the company-level priorities.

The team backlog (or the work done by teams) is clearly aligned with the company strategy and OKRs,[3] which allows the entire company to be in lockstep, pulling together toward the same goal.

[1]Full-time equivalents.
[2]Current quarter + next 18 months.
[3]Objectives and key results.

Source: McKinsey analysis

day-to-day execution, but they also allow funding to be anchored to iterative tranches of outcomes. The portfolios publish the specific outcomes they will drive during the year, with a deep view into which parts will be measurable in the next three to six months. As a result, the up-front funding allocation at the start of the year has a more concrete and near-term yardstick to calibrate investments and ensure that the highest-value outcomes receive adequate capacity early on.

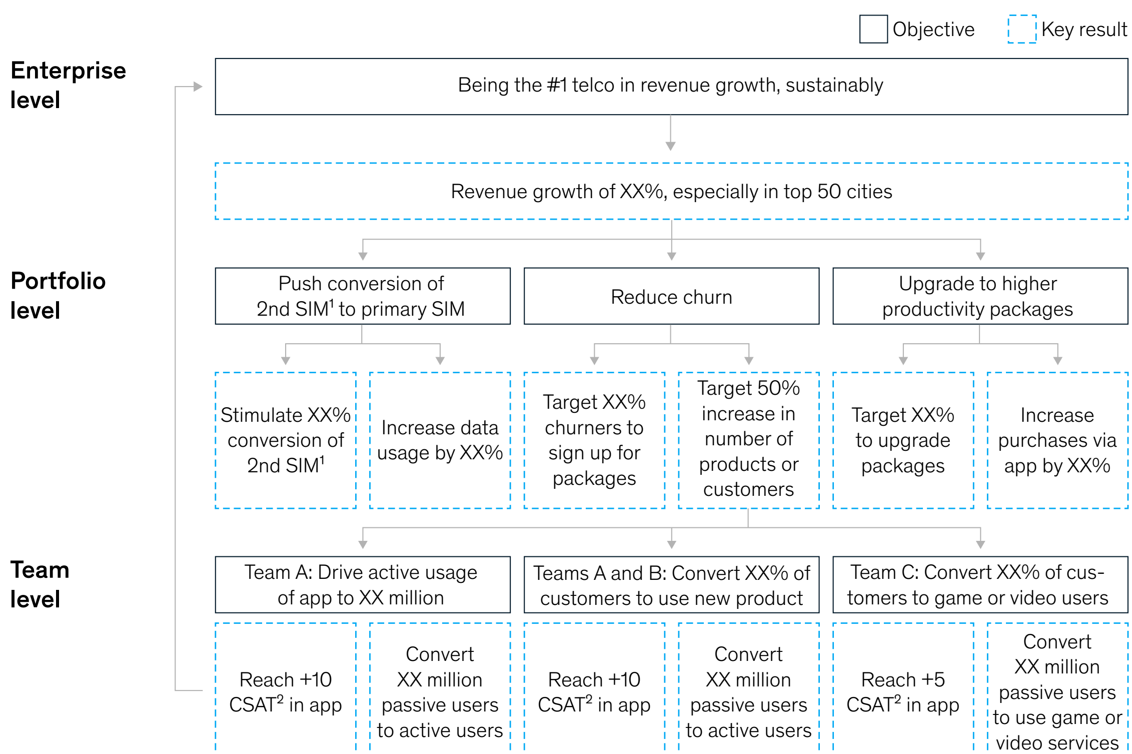
From immovable monolithic investments to fluid funding allocations based on performance

Many traditional organizations struggle to pause or stop initiatives that are not achieving their intended objectives because they don't review outcome delivery until a project is completed, which often is too late. In fact, substantial effort goes into governing project schedules and spending, yet none goes into assessing whether the project is expected to yield the value promised in the up-front business case. Similarly, they are unable to dynamically allocate talent, such as a high-performing data scientist or marketer, to maximize returns because these team members are isolated and "protected" within project silos.

Agile companies create transparency into portfolio performance and have the flexibility to shift priorities and talent through a quarterly business review (QBR) process.[3] During the QBR, executive teams and business unit portfolio leaders come together to check progress against outcomes from the previous quarter, assess priorities for the next quarter, and reallocate resources accordingly. Pivoting resources is a common practice (Exhibit 4).

Exhibit 4

Objectives and key results cascade from the enterprise level to the agile-portfolio and team levels.



[1]Subscriber identity module.
[2]Customer satisfaction score.
Source: McKinsey analysis

[3] For more on the quarterly business review process, see *McKinsey Organization Blog*, "Quarterly Business Review: How to extract benefits beyond transparency," blog entry by Quentin Jadoul, Akos Legradi, and Dániel Róna, McKinsey, October 5, 2020.

A global retail client implemented QBRs and introduced a prioritization approach that evaluated performance and established a "kill rate" metric to track the percentage of low-value-added work stopped or paused every quarter.

From finance as a control function to finance as a strategic business partner for continual value capture

Traditionally, finance is seen as a control function, asking questions and conducting audits of project costs and schedule overruns. Project leaders see financial reporting as overhead, given that not much of the reporting informs day-to-day decisions. Worse yet, applying this reporting approach to agile portfolios creates significant friction because continuously evolving agile backlogs don't conform to the model.

With the shift to agility, the accountability for managing outcomes against spending falls more heavily on portfolio leaders. Each portfolio leader (and each product owner within the portfolio) functions as a "mini CEO" responsible for continuously monitoring progress. Finance (or a dedicated financial planning and accounting partner) plays a pivotal role in providing timely, relevant insights on spending and financial outcomes to the portfolio leader, who can then decide how to shift capacity toward higher-priority outcomes. To enable this, portfolio leaders and their teams would ideally receive real-time reporting on the following:

- progress on results (OKRs), including P&L metrics from finance, such as impact on revenue (for example, through improved retention or renewal rates) and cost (through operational improvements)

- resource consumption tracked against the budget envelope, including an integrated view of capital expenditure and operational expenditure utilization (including enterprise-level allocations such as hardware costs) per agile sprint; this information would be provided by finance

- agile-delivery metrics such as progress on backlog execution (for example, using burn-up or burn-down charts that show, respectively, how much work is completed or remaining), team engagement, time to market, and quality

Finance plays a critical role in standing up a unified infrastructure that makes this information accessible and acts as a problem-solving partner to portfolio leaders, helping them translate insights into action and demonstrate the value of the portfolio to the enterprise. This fundamental change in finance's role depends as much on a shift in mindset as it does on investments in new processes and tools.

Getting started

As with everything in agile, the best way to try a large-scale effort is to start with a high-level vision and blueprint of the target state, pilot the new methodologies, and then continually refine the nuances based on the results.

One approach is to work backward from the next funding cycle in three phases:

- *Phase one.* Start early in the year, and use the first and second quarters to give key executives time to align on the high-level blueprint. Outline what will be new, what will get phased out, and what will be retained in the future-state operating model.

- *Phase two.* During the second and third quarters, run two batches of pilot QBRs to provide training on the fundamentals, including, for example, OKR-based prioritization and reporting at QBRs. This will help the portfolio come up to speed on shifting to outcome-based planning and decision making—in time to apply these tools in the upcoming annual funding cycle.

- *Phase three.* Shift to the new, persistent outcome-backed funding model in the fourth quarter for portfolios that have completed pilots. Complete the rollout over the next few quarters as remaining portfolios come up to speed.

Pitfalls to avoid while shifting to agile funding

Organizations can bolster their chances of success when designing the new funding operating model by avoiding a few common pitfalls:

Not aligning agile portfolios to the way business is structured. Too often, portfolios mirror IT architecture instead of the way the business and customers operate. This makes it challenging to align funding neatly to business outcomes given that almost all outcomes may end up getting fragmented across multiple portfolios. Outcome-based planning and funding becomes much more effective if the portfolios mirror business priorities, enabling one-to-one mapping of portfolios to outcomes and outcomes to funding.

Running old and new models concurrently for too long. Even if the organization has a mix of agile and nonagile teams, it is important to adopt a single funding and planning model, including leveraging concepts like OKRs and QBRs, to harmonize governance and investment decision making. Maintaining two funding models creates additional overhead and makes it difficult to consistently integrate new approaches, define roles and responsibilities, and align on shared language and tools.

Insufficient automation of tracking spending and outcomes. Absent a sufficient level of automation, manual overhead increases, as does the likelihood of human error. It becomes an impossible challenge for portfolio managers to continually track work and outcomes. As a result, ongoing conversations about outcomes—during annual planning and funding cycles or during QBRs—might remain suboptimal, diluting the confidence of senior executives.

Leaders micromanaging teams and failing to adapt to outcome-driven decision making. Leaders should engage and share direction on target outcomes and milestones at a strategic level while allowing teams to chart their own course for how to best deliver on those goals. Executives who are overly involved in backlog-level work may lose sight of overarching enterprise goals, preventing teams from making informed, nonbureaucratic decisions based on their ground-level facts and observations.

Pivoting to agile funding can be extremely challenging for CFOs because funding and budgeting mechanisms are ingrained in most organizations—and rightfully so, given their role in P&L and financial risk management. However, the idea is not to uproot the financial rigor that financial planning and accounting functions need to maintain from a risk, regulatory, and business management perspective. Instead, it's to refine the way that change portfolios are funded and tracked to allow greater transparency and control into how investments are being consumed.

Designing the shift to agile funding, therefore, requires careful decision making along multiple parameters. Courage and commitment to the new approach from senior leaders can help agile practitioners and finance professionals come together to truly improve planning and funding methodologies and mindsets and to prepare their organizations for the future.

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