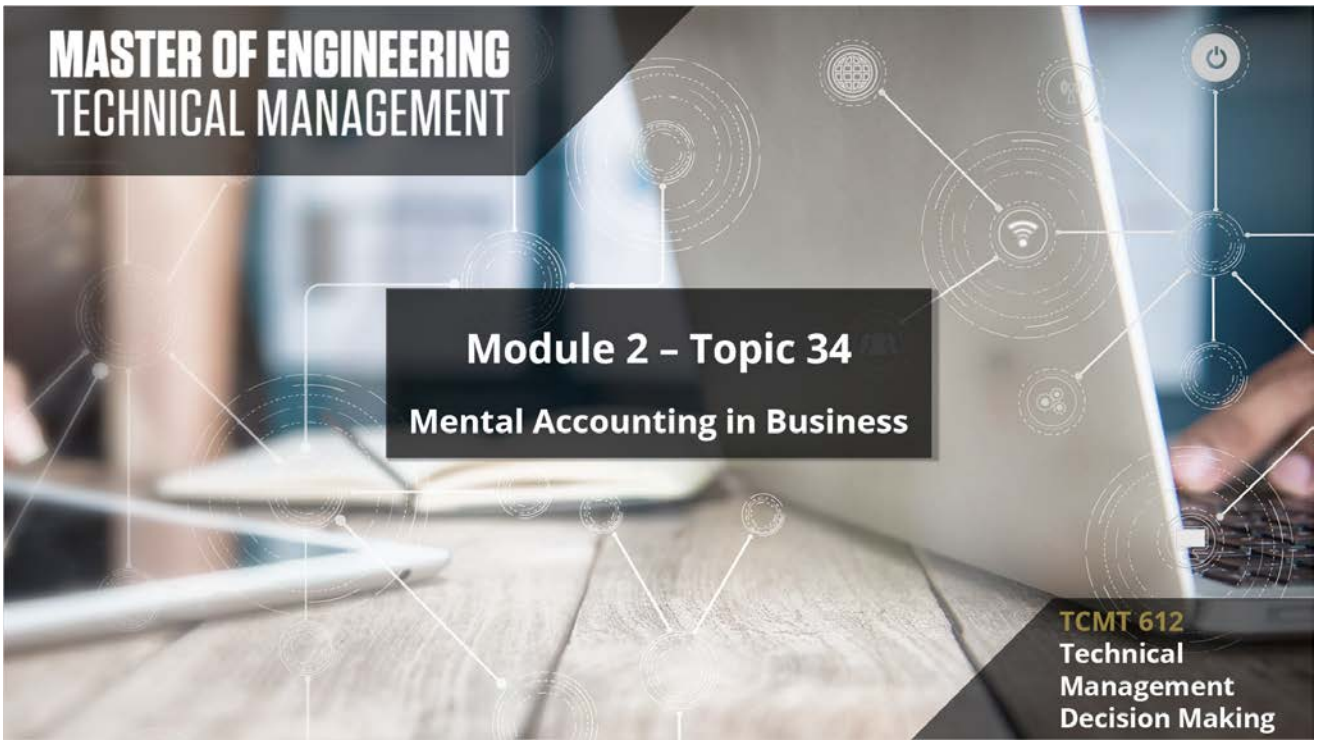
TCMT612_02M_034T_Mental-accounting-in-business

1. Main

1.2 Topic title



Notes:

In this topic the professor discusses mental accounting in business.

1.3 Introduction

Notes:

If used properly, mental accounting can play a large positive role in managing projects and product portfolios.

In fact, mental accounting is one of the primary underlying principles behind business-driven decision making processes that we are going to cover in the rest of the course.

1.4 Portfolio manager

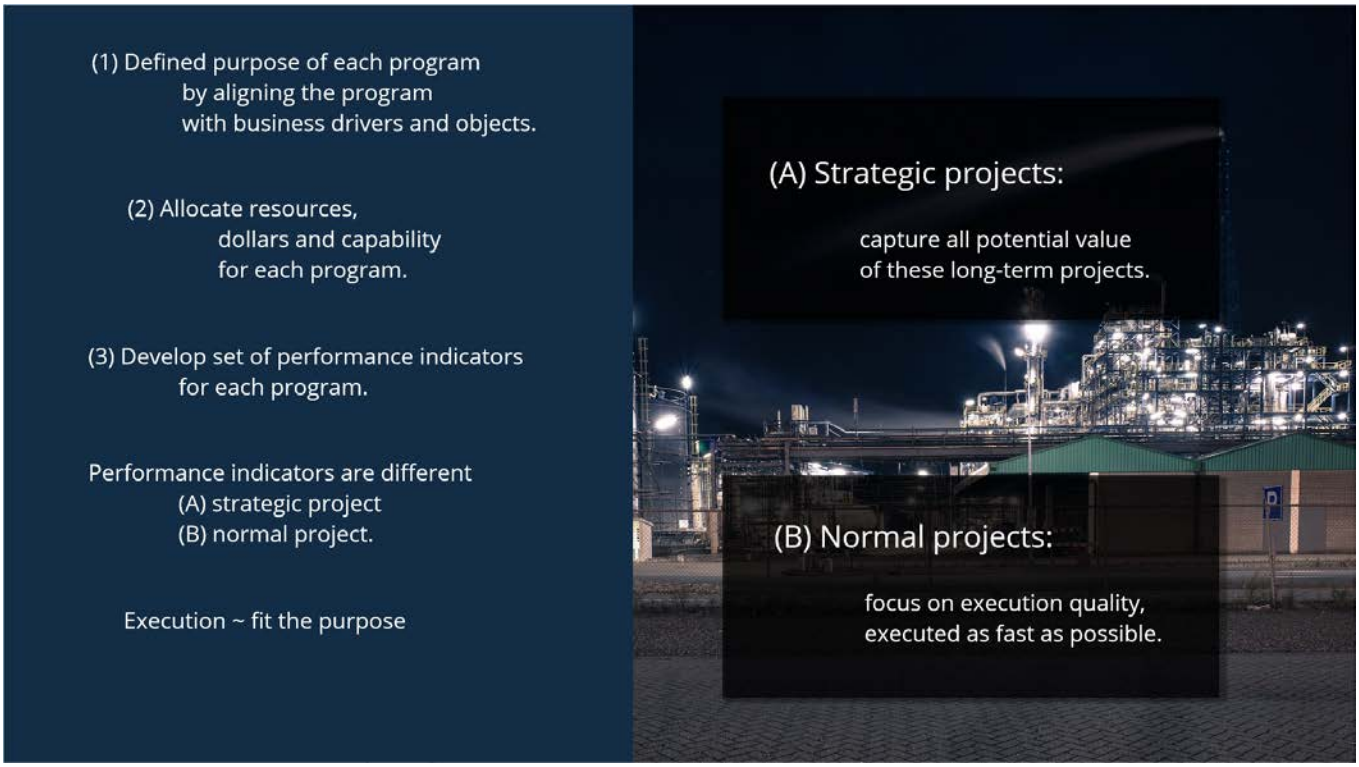
Notes:

When I was the portfolio manager of British Petroleum, one of the management difficulties that I faced was to make consistent decisions for a variety of different projects with different purposes, different execution time frame, different risk profiles, and different value propagations.

To solve this problem, we developed a value-driven portfolio decision making process based on the mental accounting principle.

We allocated our total budget into different programs: strategic programs, and normal programs.

1.5 Alignment



Notes:

We defined the purpose of each program by aligning the program with business drivers and objectives.

Then we will allocate the resources, including dollar and capability, for each program.

Also we developed different set of performance indicators for each program.

The performance indicators are different for a strategic project and normal project.

Managing the execution was a need to fit for the purpose of each problem.

For normal projects we need to focus on the execution quality.

Make sure that the project is executed as fast as possible.

But for a strategic program, we want to capture all the potential value of these long-term projects.

1.6 Improve performance

Notes:

Another step of the decision-making process, is to continuously improve the performance of those projects.

Every quarter we review the projects and make adjustment decisions.

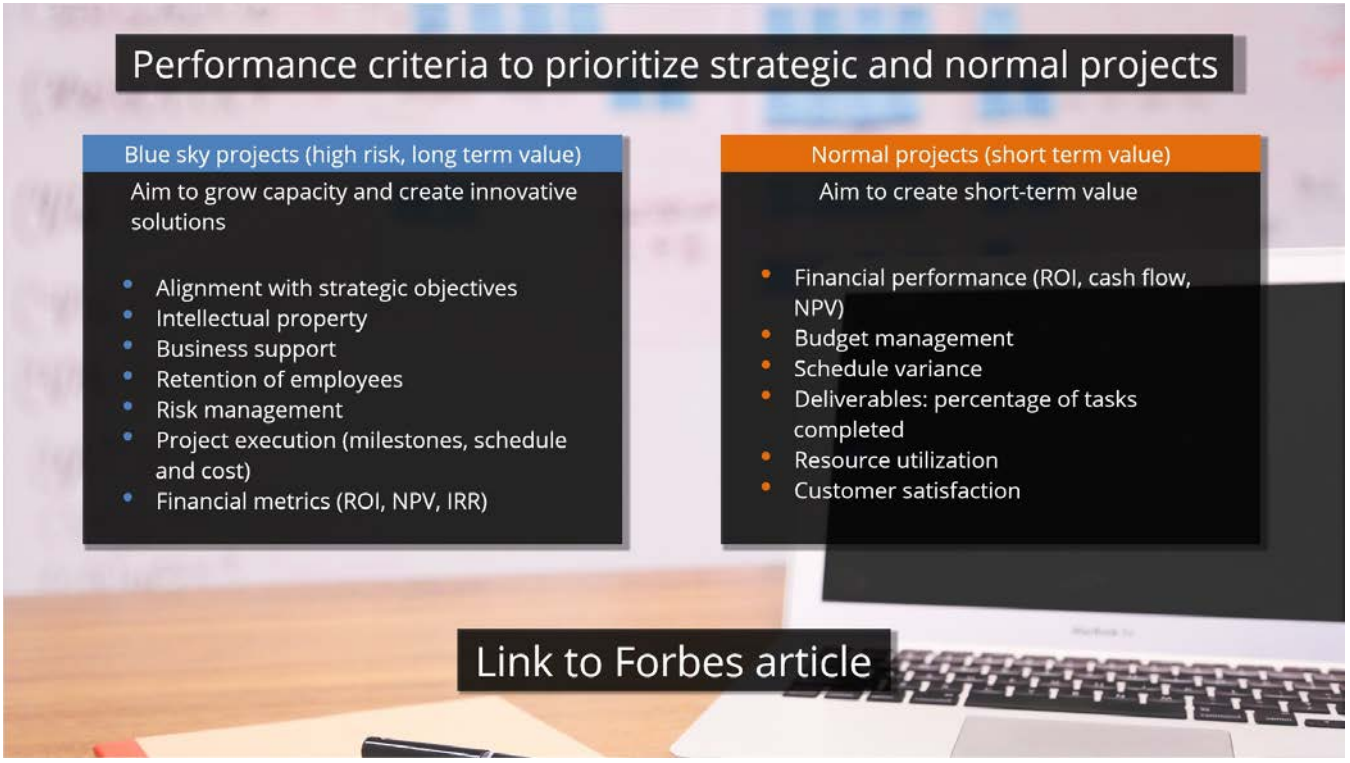
With the mental accounting principle we were able to make appropriate decisions for projects in different categories to maximize the unique value of each project and

also minimize the risk associated with each unique program.

The decision-making process enabled our executives to mitigate their judgment bias and make consistent portfolio decisions to maximize the value of the whole portfolio in a consistent and systematic manner.

To make appropriate use of mental accounting in portfolio management, it is critical to define a set of specific criteria for each category.

1.7 Performance criteria



Notes:

This slide lists some examples of performance criteria that you can use to help you prioritize projects in strategic programs and normal programs.

For a strategic project, or "blue sky" type of high-risk/high-return projects, the purpose is to grow capacity and create innovative solutions.

The first criterion could be the alignment between the projects with long-term strategic objectives of your company.

The second criterion can be the creation and protection of intellectual property of innovations that come out of the program.

The intellectual property can provide a significant competitive advantage to your business.

It is prudent to gain sustainable support from your business department for those long-term projects, to keep those projects relevant to the market demands in the long run.

Retention of employees is critical for long-term projects, because those products aim to create new capability for a company, and new capability resides in employees. The evaluation criterion can be very different for short-term projects. Short-term projects aim to create short-term value.

Because of that, the financial performance return-on-investment, cash flow, and net present value are the most important performance indicators, followed by budget management.

We need to have a sufficient budget to deliver the project. We do not have to go through all the details of the table.

The point I want to make from this example is that mental accounting is a powerful fundamental tool for data-driven decision-making, and we need to design a specific set of criteria for each program to ensure our decisions fit the purpose of those projects.

1.8 Test

Notes:

Now that you have completed this part of module 2, you are ready to take the following 2-part test on eCampus.